MANITOBA TELECOM SERVICES INC. Annual Report 2003

we are here

MTS®

MTS at-a-glance

MTS Communications Inc.

As the primary telecommunications provider in Manitoba, MTS Communications offers a full range of enhanced local, long distance, and wireless telecommunications, as well as Internet and digital television services. The company has a fully digital, province-wide network; a cellular network covering 96% of Manitoba's population; and leading edge digital wireless services featuring 1xRTT enhancement, paging, and group communications networks. Through its affiliate, AAA Alarm Systems Ltd., MTS Communications provides residential and business security systems throughout Western Canada.

MTS Media Inc.

MTS Media focuses on the delivery of advertising solutions and content services to merchants and consumers in Manitoba. Publishing 10 different directories, including the White Pages and Yellow Pages™, this company also operates the myWinnipeg.com and myManitoba.com Internet portals, as well as a growing specialty publishing business producing titles such as *myWinnipeg Life* and *myWinnipeg Business* magazines. The company operates Directory Data Services, and also provisions content to other MTS devices and initiatives such as the mobile browser and the MTS TV portal.

Qunara Inc.

Qunara is a leading and trusted North American provider of advanced information technology solutions and managed services, with unique capability and proven experience in the areas of risk management, and information technology security, content, information and knowledge management, and Web services. Qunara is headquartered in Winnipeg, with offices in Halifax, Ottawa and Toronto.

Contents:

to drive value

Here is where we outperform. With the highest levels of operating efficiency in the industry. Strong profitability and cash flow. Growing market leadership. Solid shareholder returns. And carefully calculated new revenue opportunities.

Here is where the heart of our business beats, enabling MTS to connect with customers like no competitor can. Entrenching loyalty to our brand in local, long distance, wireless, and broadband services, and receptiveness to new offerings like digital TV.

Here is where we execute prudent decisions that pave the way for maximizing potential. Our vision shows us where. Our values show us how. Our customers are why.

we are here >

to deliver results

Financial highlights

Years ended December 31	2003	2002[1]	% change
(in millions, except earnings per share)			
Consolidated			
Revenues	$ 844.7	$ 927.3	(8.9%)
EBITDA [2]	443.3	410.1	8.1%
Net income	85.8	162.5	(47.2%)
Earnings per share	1.36	2.53	(46.2%)
Baseline (continuing operations) [3]			
Revenues	$ 844.7	$ 835.1	1.1%
EBITDA	448.4	439.2	2.1%
Net income	115.2	112.2	2.7%
Earnings per share	1.83	1.75	4.6%

(1) The financial results for 2002 were restated for a change in accounting policy for stock options granted to employees, which was adopted January 1, 2003.

(2) Earnings before interest, taxes, amortization, equity losses, goodwill revaluation and other income.

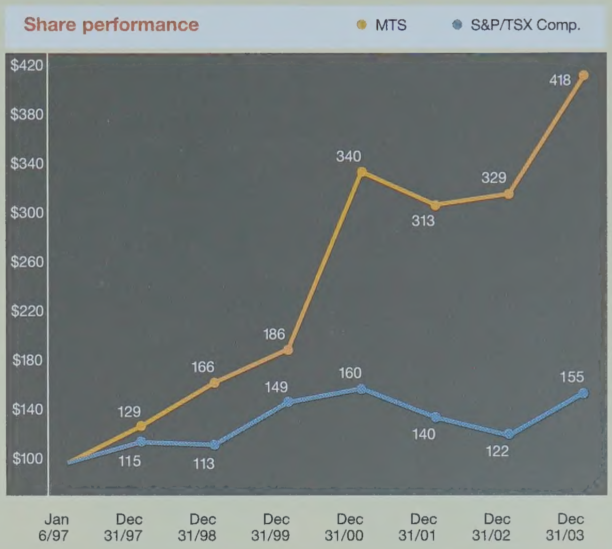
(3) Baseline results exclude the impact of Bell West Inc. in 2003 and 2002, and the impact of Bell Intrigna Inc. in 2002. Baseline results from continuing operations also exclude the impact of restructuring charges in 2003 and 2002, and the impact of the goodwill revaluation in 2003.

Non-GAAP measures of performance

We provide information concerning baseline operations, EBITDA, free cash flow, and continuing operations in our 2003 Annual Report because we believe investors use them as measures of our financial performance. These measures do not have a standardized meaning as prescribed by Canadian generally accepted accounting principles ("GAAP") and are not necessarily comparable to similarly titled measures used by other companies. These non-GAAP measures of performance are discussed in Management's Discussion and Analysis on pages 16 and 17.

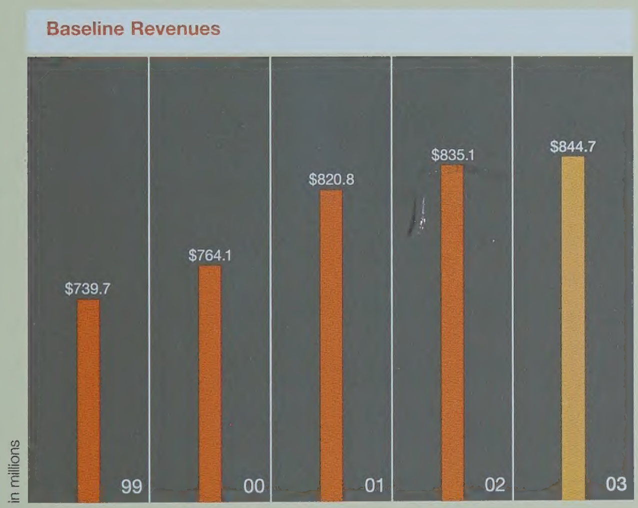
Forward-looking statements

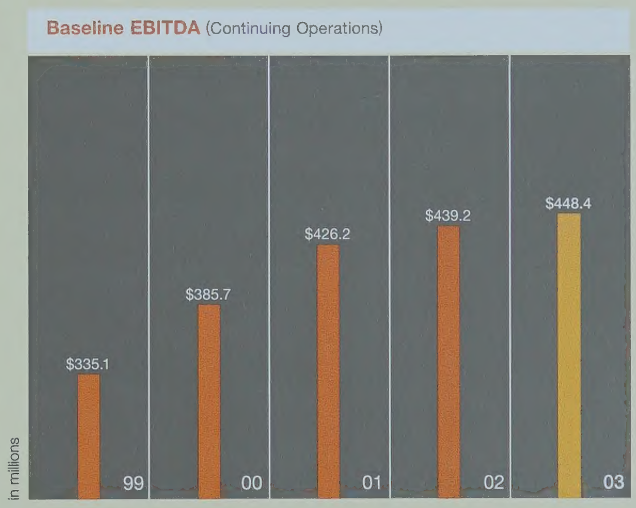
Our 2003 Annual Report includes forward-looking statements about our corporate direction and financial objectives that are subject to risks, uncertainties and assumptions. As a consequence, actual results in the future may differ materially from those projected or suggested. Examples of statements that constitute forward-looking information may be identified by words such as "believe", "expect", "project", "anticipate", "could", "target", "forecast", "intend", "plan", "outlook", and other similar terms. Factors that could cause actual results to differ materially from those expected are identified in the "Risks and Uncertainties" section of Management's Discussion and Analysis on pages 45 to 47. Please note that forward-looking statements reflect our expectations as of March 5, 2004. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

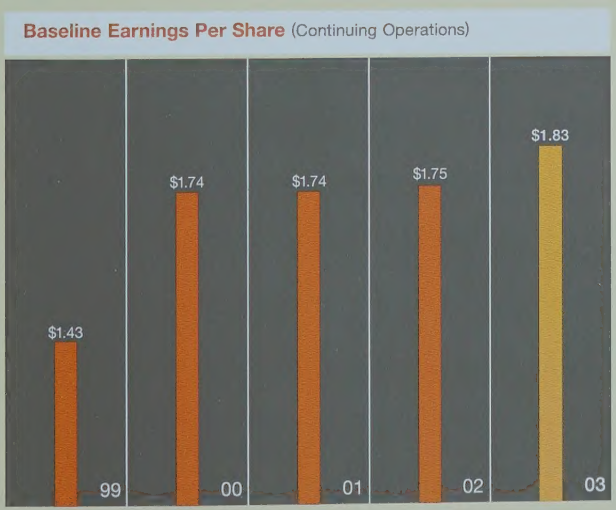


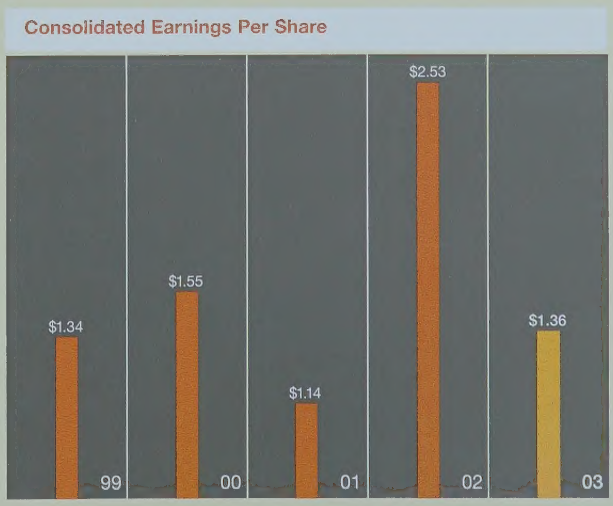
Share performance
This graph compares the cumulative total return on MTS's Common Shares over the last seven years with the cumulative total return of the S&P/TSX Composite Index, assuming a $100 investment at the initial offering price of $13.00 and reinvestment of dividends.

Five years' financial highlights For the years ended December 31









we are here

to report

To our shareholders

For 95 years, Manitoba Telecom Services has played an integral role in the economic development of Manitoba. In this time, we have developed relationships with customers that have become the foundation of a very profitable business. The depth of our relationships is reflected in our network, with a connection to nearly every home and business. It is reflected by the expanding number of services we offer, which has grown to include local, long distance, directory, wireless, Internet, e-business, security services, and now digital television. Going forward, MTS is uniquely positioned to provide one-stop shopping and complete communications solutions to every Manitoba consumer, be it residential or business.

The benefits of our customer connections are evidenced by MTS's consistent delivery of profitable growth from our baseline business, which has contributed to the creation of significant shareholder value. In fact, over the last five years, our compound annual return to shareholders has been 20% – excellent performance in an industry that has faced difficult times.

In 2003, we continued to face aggressive competition and a challenging regulatory environment, which caused baseline revenue and

Thomas E. Stefanson, FCA
Chairman

William C. Fraser, FCA
President & Chief Executive Officer

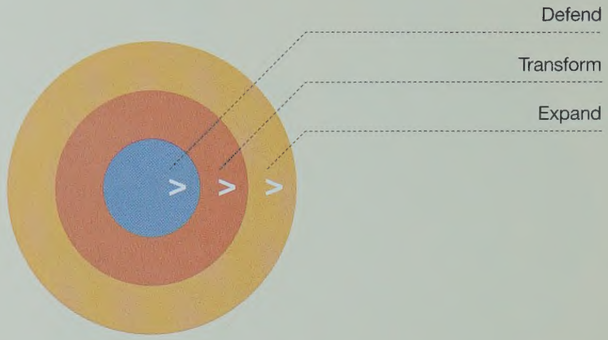
EBITDA performance to be lower than we had originally forecast. Baseline EBITDA from continuing operations increased by 2.1% to $448.4 million, and baseline revenues grew by 1.1% to $844.7 million. Most importantly, baseline earnings per share from continuing operations met our original guidance for the year, and increased by 4.6% to $1.83.

2003 marked the launch of a significant new product, MTS TV. Deployed as a means to leverage our existing network investments and to deepen customer connections, MTS TV has proven extremely popular with our customer base, exceeding targets for first year growth. This demonstrates how the relationships we have established serve as a great foundation to expand our business.

On February 2, 2004, we exercised our put option requiring Bell Canada to purchase MTS's 40% stake in Bell West for approximately $645 million. In accordance with the terms of our agreement with Bell Canada, we expect to receive these proceeds in the third quarter of 2004.

Our solid 2003 baseline results, the expansion into TV services, and our decision regarding the Bell West put option all have their origins

Our Strategy



in our corporate strategy: to defend, transform, and expand our core business.

We defend the core, our traditional lines of business – local, long distance and directory – and the vital connections to our customers they represent, through outstanding product and service offerings and excellent customer service.

We transform the core by evolving our product portfolio through services like wireless and high-speed Internet, diversifying the revenue base, and enhancing the profitability from these fast-growing services.

We expand the core through the introduction of new related services and investments in adjacent businesses to capture profitable growth.

Standing on the cornerstones of a 95-year relationship with our market and our $2.1 billion network in Manitoba, this strategy delivered solid improvements in 2003. We continued to grow our revenues and expand our service base, increase market share in key sectors, and capture efficiencies at every opportunity.

Our solid 2003 baseline results have their origins in our corporate strategy to defend, transform, and expand our core business. In 2003, we continued to grow our revenues and expand our service base, increase market share in key sectors, and capture efficiencies at every opportunity.

Defend the Core

In traditional operations, MTS continues to lead with estimated market shares of 97% and 76% in local service and long distance, respectively. These services, together with our directory business, contributed $590.2 million in revenues for the year. We have maintained our leadership position in the face of growing competition, which is a testament to the strength of our brand.

Transform the Core

In 2003, we made significant gains in the high-speed Internet segment, increasing our estimated share of the market to 46% by year-end, becoming the leading Internet service provider in Manitoba. Our DSL High Speed Internet service was extended to 35 new communities in 2003, and now reaches 79% of Manitobans. We accomplished a significant goal this year, pushing through our target of 76,000 customers to reach 77,643, which contributed to the achievement of $44.8 million in revenues, representing strong double-digit growth of 24.4%.

Transform the Core Wireless Customers

In wireless services, 2003 saw us expand our 1xRTT capabilities to 95% of Manitoba's population. This enabled MTS to seize more revenue opportunities by offering advanced wireless services, such as mobile Web browser and mobile e-mail, to more customers across the province. Thanks to our advanced network that covers 96% of the population, our wireless line of business delivered revenues of $159.4 million in 2003 – a strong increase of 16.0%. We continue to lead the wireless market and once again posted industry-leading results in both customer churn levels and average revenue per customer. These results are further evidence of our brand strength, and support our view that our connections with our customers will continue to strengthen as adoption of wireless services continues to grow in Manitoba.

Expand the Core

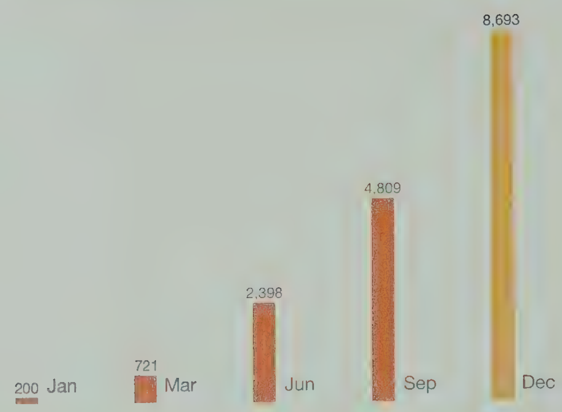
Our MTS TV service, launched in January, exceeded our initial expectations. At the end of 2003, 8,693 customers had signed on to the service, surpassing our original forecast by 45%. At December 31,

In 2003, we continued to lead the wireless market. Our connections with our customers will continue to strengthen as adoption of wireless services continues to grow in Manitoba.

our TV service was available to 42% of Winnipeg, and demand continues to be very positive. Customers enjoy the digital quality service and selection, and have responded enthusiastically to a TV and DSL High Speed Internet service bundle. 2003 marked an outstanding start for this new service which provides yet another connection to our presence in the Manitoba home.

Qunara, our e-business subsidiary, faced market demand weakness through 2003. Notwithstanding the slower conditions, we continued to work towards ensuring that Qunara is well-positioned for a recovery in the sector. We streamlined operations and focused on the market sectors where Qunara has particular expertise, including the security and managed services areas. Through the year, we landed some major contracts with large corporate accounts, as well as government departments and Elections Canada, a major agency of Parliament. With the activities we completed in 2003, we believe Qunara is well positioned to improve performance going forward.

Expand the Core MTS TV 2003 Installed Customers



In 2004, we will maintain our focus on the key business strategies of defending, transforming, and expanding our operations. As the Manitoba market continues to evolve and develop, MTS will be there, leveraging its network investments to provide services to customers and generate profitable growth.

We will ensure our core business remains profitable by defending our market position and maximizing our efficiencies. We will continue to identify opportunities for profitable expansion of our broadband network to new communities in Manitoba. We will look to further leverage our 1xRTT network to offer new wireless services to our customers, which will contribute to supporting revenue and profitability growth in a competitive market.

For MTS TV, we look forward to continuing strong customer demand for 2004 as we expand our network footprint to 66% of Winnipeg. With our bundling plans, this expansion will not only add TV subscribers, but will stimulate high-speed Internet growth. We expect that this enhanced relationship with our customers will help to sustain our success across our portfolio of services.

MTS TV exceeded our initial expectations. We look forward to continuing strong demand in 2004, as we expand our network footprint to 66% of Winnipeg.

In closing, our investments in our network, the expansion of our service base, and our ability to execute leave MTS in an excellent position to capitalize on the close relationships we have with our customers, and to build on the strong foundation we have worked hard to develop.

We are here. We have been here for 95 years. We are secure in our relationship with our customers, and we are confident this relationship will continue to provide our shareholders with profitable returns in the future.

Thomas E. Stefanson, FCA
Chairman

William C. Fraser, FCA
President & Chief Executive Officer

February 2, 2004

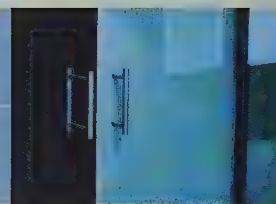
we are here

to build on success

Defend

Local and long distance

Directory



Transform

Wireless

Internet

Expand

Digital TV

Network opportunities

Annual revenues

$590 million

Annual revenue derived from traditional operations

Estimated market share

97%

Market share in local services

76%

Market share in long distance services

Market opportunity

700,980

Network Access Services

New products and services draw more revenues from each network access service

Revenue growth

18%

Revenue growth in wireless and Internet services

Value-added services like Mobile Browser™ drive wireless network usage and revenues

Estimated market share

68%

Market share in wireless services

46%

Market share in consumer high-speed Internet services

Market penetration

255,657

Wireless subscribers

Manitoba wireless and Internet markets offer further opportunities to grow

77,643

Consumer high-speed Internet customers

Customer growth

MTS TV outperformed first year customer target by

45%

MTS TV [illegible] opportunities for MTS High Speed Internet

Coverage

[illegible]

42% [illegible]

66% [illegible]

85% [illegible]

Market opportunity

26,000+

[illegible]

$100 million+

Potential market for TV services in Winnipeg

we are here

to discuss

Management's discussion & analysis

This Management's Discussion and Analysis ("MD&A") of our financial results for the period ended December 31, 2003, is as at March 5, 2004. In this MD&A, "we", "our", and "us" refer to Manitoba Telecom Services Inc. ("MTS"). Subsequent to the date of this MD&A, on March 18, 2004, MTS entered into an Arrangement Agreement with Allstream Inc. pursuant to which MTS will acquire all of the Class A and Class B shares of Allstream Inc. Information regarding this proposed acquisition is provided under "Proposed Transaction" in the Outlook section of this MD&A beginning on page 51. The acquisition of Allstream Inc. represents a significant change to our business, and as such, should be carefully considered when assessing MTS's future prospects.

This MD&A should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2003. The financial data contained in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All financial data is reported in millions of Canadian dollars, unless otherwise noted. This MD&A and the financial information contained herein have been reviewed by our Audit Committee and approved by our Board of Directors.

This MD&A includes forward-looking statements about our corporate direction and financial objectives that are subject to risks, uncertainties and assumptions. As a consequence, actual results in the future may differ materially from those projected or suggested. Examples of statements that constitute forward-looking information may be identified by words such as "believe", "expect", "project", "anticipate", "could", "target", "forecast", "intend", "plan", "outlook", and other similar terms. Factors that could cause actual results to differ materially from those expected are identified in the "Risks and Uncertainties" section of this MD&A. Please note that forward-looking statements reflect our expectations as of March 5, 2004. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Additional information relating to our company, including our Annual Information Form, is available on SEDAR at **www.sedar.com.**

"We are the leader in our core markets, constantly evolving, financially strong and flexible. Consistency and stability are hallmarks of our business approach. Our shareholders have benefited, and will continue to benefit, from MTS's strong financial performance."

Wayne S. Demkey, CA
Executive Vice-President Finance & Chief Financial Officer
and Corporate Controller

NON-GAAP MEASURES OF PERFORMANCE

We provide information concerning baseline operations, continuing operations, EBITDA, and free cash flow because we believe investors use them as measures of our financial performance. These measures do not have a standardized meaning as prescribed by Canadian GAAP and are not necessarily comparable to similarly titled measures used by other companies.

> **Baseline** – We refer to our baseline business or operations. These operations encompass everything MTS does, with the exception of our investment in Bell West Inc. ("Bell West"). MTS's consolidated results include our baseline operations as well as the financial impact from our 40% minority interest in Bell West. We structure our discussion and reporting in this manner because we believe investors find it useful in assessing the value of MTS as a whole. As such, our baseline financial results in 2003 exclude the impact from Bell West. Baseline results in 2002 exclude the impact from Bell Intrigna Inc. ("Bell Intrigna") and Bell West.

Bell Intrigna/Bell West – In 1999, we entered into an agreement with Bell Canada which resulted in the creation of Bell Intrigna, a telecommunications company formed to expand into the business markets of Alberta and British Columbia. From June 1999 until April 10, 2002, we owned 66.67% of Bell Intrigna and Bell Canada owned 33.33%. As a controlling shareholder, we consolidated the operating results, cash flows and financial position of Bell Intrigna with our financial results.

On April 11, 2002, we entered into a new agreement with Bell Canada that changed the structure and ownership of Bell Intrigna, resulting in our ownership of 40% of a new expanded company, which was re-named Bell West. Accordingly, we adopted the equity method of accounting for our 40% investment in Bell West and discontinued consolidation of Bell Intrigna's results. The terms of the agreement also established a series of liquidity provisions (put and call options) for the shareholders of Bell West. On February 2, 2004, we exercised our put option requiring Bell Canada to purchase our 40% investment in Bell West in exchange for cash proceeds of approximately $645 million.

> **Continuing Operations** – We provide information that refers to our performance from continuing operations. Continuing operations exclude the one-time accounting gain resulting from the transaction that created Bell West on April 11, 2002, restructuring charges involving workforce reductions, and a goodwill revaluation charge associated with Qunara, our e-business division.

> **EBITDA** – We define EBITDA as earnings before interest, taxes, amortization, equity losses, goodwill revaluation and other income. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with Canadian GAAP) as a measure of liquidity.

> **Free Cash Flow** – We define free cash flow as cash flow from operating activities, less investing activities, dividends and excluding changes in working capital. Free cash flow is the amount of discretionary cash flow that we have for

"Our business depends on customer calls. MTS has provided us with the technology to manage our call centres more efficiently, ensuring we never lose touch with our customers, no matter where they call from."

Don Carson
President
Belko Canada
(exclusive distributor of the Bowflex Fitness Machines)

purchasing additional assets beyond our annual capital expenditure program, retiring debt, buying back shares, or increasing dividends.

OVERVIEW

We are here: MTS, the market leader in Manitoba

MTS is the pre-eminent full-service provider of telecommunications in Manitoba. We have been the clear market leader in Manitoba for as long as the company has existed. Operationally our business is organized into three main segments providing an extensive portfolio of services:

Manitoba Telecom Services Inc.

MTS Communications Inc.	MTS Media Inc.	Qunara Inc.
> Local > Long distance > Wireless > Internet > Terminal equipment > Security services (AAA Alarm Systems Ltd.) > Digital television	> Directory Yellow Pages™ White Pages > Online content	> e-business and application services > IT security > Internet Data Centre services

Our communications services are unified by their:

> broad or mainstream appeal to business and residential customers.
> delivery across a broadband network that reaches across Manitoba.
> potential for being bundled to meet our customers' needs.
> ability to interconnect to networks beyond Manitoba.
> strategic value in sustaining our business for the long-term.

2003 results in summary

We had another year of solid results and improved profitability in the baseline operations. We reported strong growth in wireless, Internet and digital television. Growth was partly offset by the impact of competitive pressures in long distance, softer market conditions in e-business and a regulatory ruling affecting local service revenues associated with high-cost serving areas. Notwithstanding more modest revenue growth in 2003, we started the year in a strong position financially, strategically and operationally in our home market of Manitoba. And that's how we ended the year.

Baseline Operations:

> Earnings per share ("EPS") from continuing operations improved by 4.6%, in line with our guidance.
> EBITDA growth from continuing operations at 2.1% met our revised guidance.
> At 1.1%, revenue growth fell marginally short of our revised guidance of 1.5%.
> Capital expenditures of $208.1 million were consistent with our expectations for the year.
> Strong free cash flow generation of $35.6 million also met our guidance.

On balance, we are pleased by our 2003 performance. Earnings and cash flow results were very good. Our operations continue to grow profitably and to generate significant free cash flows. This, together with our strong balance sheet, enables us to

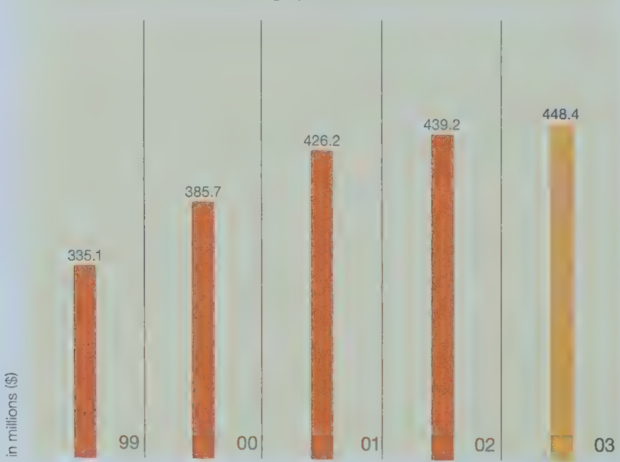
we are here

to knock on every door

Our extensive portfolio of services, from local, long distance, and wireless to Internet and digital television, enables MTS to maintain a profitable presence in nearly every home and business in our home market.

continue to deliver shareholder value by investing to grow the business and by paying out attractive dividends. In 2003, we increased our quarterly dividend to $0.25 cents per share – a 13.6% improvement. We also purchased for cancellation 881,336 Common Shares for $30.8 million. Our longer-term results have been reassuringly steady and consistent in delivering annual profitability gains.

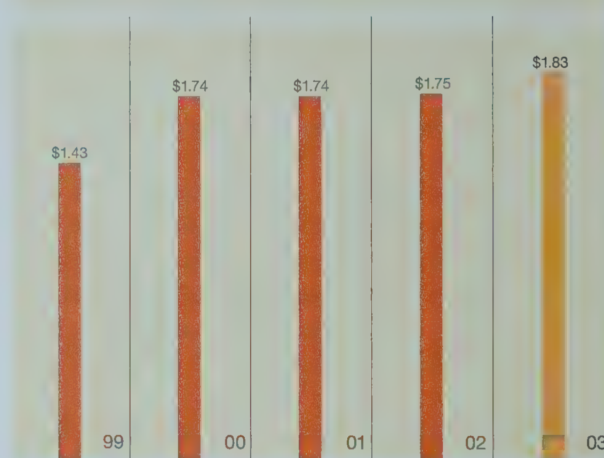
Baseline EBITDA (Continuing Operations)



Bell West – exercising the put option

On February 2, 2004, we formally exercised the put option that divests us of our 40% equity investment in Bell West, which was formed by Bell Canada and MTS in 1999 under the name Bell Intrigna to market business telecommunications services in Alberta and British Columbia. Under the provisions established in the Bell West shareholder agreement, Bell Canada is obliged to purchase all of our shares in Bell West for approximately $645 million.

Baseline EPS (Continuing Operations)



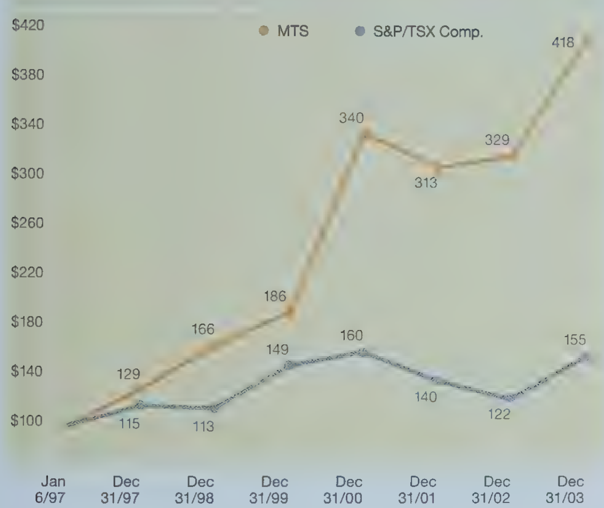
We believe exercising the option is the best course of action for MTS. By selling our 40% interest, we have locked in an attractive return on investment. With the exercise of the put option, we will recognize a one-time pre-tax accounting gain of approximately $230 million on the sale of our investment in the first quarter of 2004.

Bell Canada has up to 180 days after the date the put was exercised – which was February 2, 2004 – to pay MTS. We expect payment on or before August 3, 2004.

Vision: our shareholder focus

Simply stated, our vision is: To profitably build upon our leadership position as the pre-eminent provider of communications services in Manitoba.

Share Performance (Value of $100 Investment)



This graph compares the cumulative total return on MTS's Common Shares over the last seven years with the cumulative total return of the S&P/TSX Composite Index, assuming a $100 investment at the initial offering price of $13.00 and reinvestment of dividends.

Our vision is grounded in creating and then delivering value to our shareholders by producing business results marked by steady increases in profitability over the long-term. In support of our vision we are committed to connecting Manitobans to each other and to the world in the way they choose. This means providing the full portfolio of services to meet the needs of a communications-intensive economy.

Strategy

Our strategy is to defend, transform and expand our core business in our home market of Manitoba.

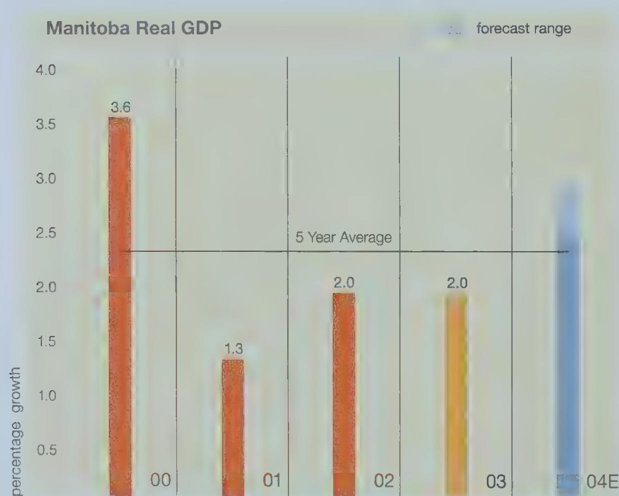
Core Business	Strategy
> Local voice connections/ enhanced calling features > Long distance > Directory > Terminal equipment	**Defend the core** by gaining efficiencies and improving our understanding of customer needs in providing traditional telecommunications services. The MTS franchise and our brand loyalty were built upon traditional telecommunications services that continue to deliver tremendous value to our customers and shareholders.
> Wireless > High-speed Internet > Broadband data networking > Security	**Transform the core** by meeting our customers' expectations for value, flexibility and innovation in the newer communications services. This involves evolving the way some of our services are packaged, delivered and supported toward the goals of strong, profitable long-term growth and customer retention.
> Digital television > e-business	**Expand the core** by targeting a larger share of the expanding communications dollar of our customer base. As convergence happens more forcefully in the years ahead, opportunities will arise to further leverage our strengths in telecommunications.

Performance drivers – factors that impact future success

There are factors that affect the performance of our company as a whole and others that impact specific businesses. For MTS in aggregate, the following performance drivers apply:

Economic Outlook The economic prospects and performance of the Manitoba economy have a direct impact on us. Manitoba has traditionally delivered solid predictable growth. We believe

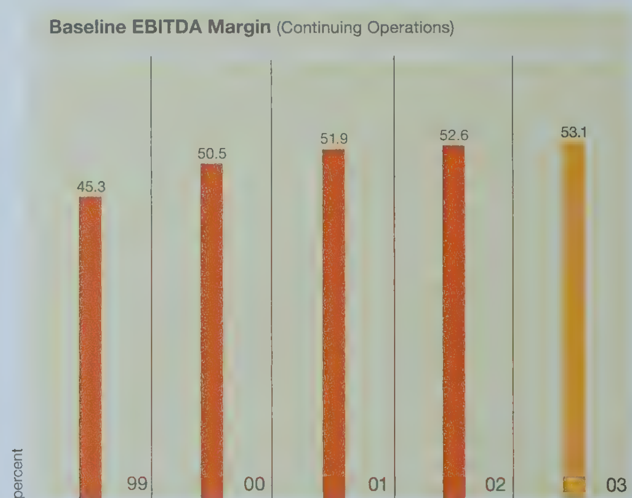
that the province has the capability to expand its potential as a transportation, manufacturing, agricultural and networking hub that will, in future, continue to sustain our vision.



Source: Manitoba Department of Finance, February 11, 2004

Customer Demand In every aspect of our business, we have experienced rising expectations from our customers. Across all areas of social and economic life in Manitoba, as elsewhere, there is a growing reliance on communications at work, at home, and on the move. Our ability to package, price, market, deliver and support services to meet these growing needs is fundamental to our success.

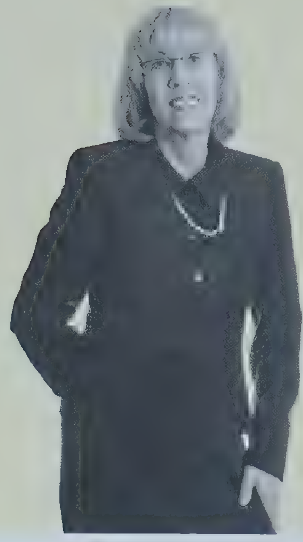
Operational Efficiency MTS's financial performance clearly indicates our commitment to operating efficiently, while, at the same time, delivering high-quality service. As our networking infrastructure evolves, and as competition evolves, we will face new challenges to ensuring our ongoing operational and cost leadership position.



Competitive Intensity For several years, we have faced significant competition in many of our core and most profitable, high-growth markets. As our business evolves and expands into new service areas, and as new competitors replace or supplement the efforts of those who have not succeeded in our operating territory, we must be vigilant in our response to new threats to our market leadership.

"With a connection to nearly every home and business in Manitoba, and an expanding range of services to offer across those connections, MTS is in an outstanding position to deliver sustained profitable growth."

Cheryl Barker, CA
President & Chief Operating Officer
MTS Communications Inc.



Leadership position – Manitoba

Line of Business	Estimated Market Share (%) December 31, 2003
> Local	97
> Long distance	76
> Wireless	68
> High-speed Internet	46

The "Triple Play" As the cable and telecommunications sectors continue to evolve, the expectation is that we will increasingly be providing competitive services to the same customers. Our success in defending, transforming and expanding our core business will be affected by our ability to offer customers what is commonly referred to in the industry as the "triple play" – digital TV, high-speed Internet and voice telephony across a single connection into the home. MTS was the first to market with the triple-play thereby creating a new growth opportunity and a strong defense against competitors.

Regulatory Environment The Canadian Radio-television and Telecommunications Commission ("CRTC") governs the telecommunications and broadcast industries in which we operate. The CRTC regulates the rates of telecommunications services where it deems there is insufficient competition to protect the interests of consumers. While the CRTC has lessened or removed the regulatory burden on certain services we provide, many of our local telecommunications services remain subject to significant regulation and are impacted by changes in regulation. The expected deployment of Internet Protocol ("IP") networks has the potential to change the cost, delivery and feature richness associated with local and long distance service both for MTS and our competitors.

We are well-positioned to compete with competitors adopting IP-based technology, but require regulation that is fair and balanced for all service providers, irrespective of technology platform.

People Our knowledge of the Manitoba market and our experience and expertise in telecommunications are important factors in our success. These key strengths will be essential to meet the market challenge in the future.

Performance drivers affecting specific businesses

Local Services: The quality of our local wireline connection remains a key differentiator in the success of our traditional operations. It is also the entry point into customer premises for high-speed Internet service and digital television. We report the number of wireline connections we have with customers, which are referred to as network access services ("NAS"). NAS is an important leading indicator of performance in the local market segment. CRTC regulation governs the prices we can charge and affects our flexibility to compete in this market segment.

Long Distance Services: The cumulative impact of strong competition over many years has created a long distance services market where there is continual margin pressure. A key driver of performance will be our ability to tailor long distance packages to meet the needs of Manitobans. We expect to bundle long distance with other offerings in ways that support the goals of customer retention and profitability.

Directory Services: Our directory services has been a very stable, profitable business for many years. As new competitors enter the market, the enduring strength of the Yellow Pages™, as an advertising brand, is a key asset in maintaining and incrementally expanding this business.

Wireless Services: Manitoba's wireless penetration rate of 32% as at December 31, 2003 is less than the Canadian average rate of 40% – an important indicator of future growth potential. The expansiveness of our digital wireless network is a significant competitive advantage and central to our long-term success in wireless. A further strength is the pervasiveness of 1 x Radio Transmission Technology ("1xRTT") capabilities in our network. 1xRTT enables us to package and offer more data-intensive services and other new revenue sources to our wireless customer base.

Internet Services: The growth and development of Web culture at work and in the home is a well-documented global phenomenon. This emerging culture is stimulating demand for broadband capacity to enable high-bandwidth applications. The widespread availability of cost-effective, and reliable high-speed Internet service on our network is central to its growing popularity in Manitoba.

Capabilities

Our success owes much to our resourcefulness in adapting to turbulent changes in our industry. Our results in 2003, as in previous years, are a positive outcome of our strategic prudence: we make investments in markets adjacent to telecommunications, but we never stray far from our strengths.

An assessment of our capabilities encompasses:

> **Shareholder Focus** We employ proven strategies to create and deliver value to shareholders. Our solid results are supported by maintaining an appropriate risk profile, a strong balance sheet, high credit ratings, and strong and growing cash flows. Our disciplined approach to cash utilization enforces a need for rigor and prudence in every business decision.

> **Customer Relationships** We have consistently demonstrated creativity and discipline in serving customers. As a result, we have the strongest competitive position in Manitoba.

> **Brand Dominance** The MTS name has an unmatchable reputation in our market. Through our business activities and community involvement over many years, we are well positioned to deliver what Manitobans want and expect.

> **Network Assets** We have $2.8 billion invested in property, plant and equipment, the largest portion of which is our network. Our network is a strategic asset that is unmatched by competitors and that underpins our ability to introduce new services in the future to deliver profitable growth.

> **Efficiency Culture** We continually focus on improving efficiency and reducing costs in support of achieving long-term success. Our metrics rank consistently at the upper end of the industry.

"Backed by MTS's deep technical expertise and solid customer support, we are able to operate a program in which videoconferencing is used for one in four court appearances in Ontario."

David Williams
Manager, Video Remand and Bail Project
Justice Technology Services
Ministry of Community Safety and Security
Ontario

Selected Financial Information

Baseline (Continuing Operations)

For the years ended December 31 (in millions $, except earnings per share)	2003	2002	2001
Revenues	844.7	835.1	820.8
EBITDA	448.4	439.2	426.2
Net income	115.2	112.2	112.3
Earnings per share	1.83	1.75	1.74

Over the past three years, our baseline performance from continuing operations has produced steady growth in revenues, EBITDA and earnings per share. These results reflect:

> Continuing strong growth in the newer communications services areas, including wireless, Internet and other broadband-enabled offerings. These improvements were partially offset by lower overall performance in the traditional telecommunications services of local and long distance.

> Our continuing efforts to reduce expenses in the low growth traditional segments of the business to preserve margins and to shift these expense dollars to support expansion in the newer high growth areas like wireless, Internet and MTS TV.

Consolidated

For the years ended December 31 (in millions $, except earnings per share and cash dividends declared per share)	2003	2002	2001
Revenues	844.7	927.3	1,003.0
EBITDA	443.3	410.1	368.0
Net income	85.8	162.5	73.7
Basic earnings per share	1.36	2.53	1.14
Diluted earnings per share	1.35	2.51	1.13
Total assets	1,684.9	1,619.3	1,661.9
Long-term financial liabilities	412.5	488.7	342.2
Cash dividends declared per share	0.94	0.82	0.76

In addition to the steady growth that characterizes our baseline continuing operations, our consolidated financial results, as presented for the years ending December 31, 2003, 2002 and 2001, respectively, also reflect:

> The deconsolidation of Bell Intrigna from our financial results effective April 11, 2002. On this date, we adopted the equity method of accounting for our investment in Bell West as a result of our ownership position moving from 66.67% of Bell Intrigna to 40% of Bell West. Our 2003 results include our 40% share of Bell West's net losses for the entire year, while 2002 results include the impact of consolidating Bell Intrigna results until April 11th, and equity accounting for our share of Bell West's net losses for the balance of 2002. This is the main reason for the revenue decrease between 2003 and 2002, and between 2002 and 2001. This change also contributed to the improvements in EBITDA, net income, and EPS from 2001 to 2003.

> The recognition of a one-time $94.2 million gain associated with the Bell West transaction in the second quarter of 2002, which produced much higher earnings in 2002, relative to 2003 and 2001.

> Workforce reduction initiatives that we undertook in the fourth quarter of 2003 and 2002, which resulted in restructuring charges of $5.1 million and $10.0 million, respectively.

> The adoption of the fair value method of accounting for stock options effective January 1, 2003. The information presented for 2002 has been restated to reflect the retroactive application of this policy. Further information is provided in the "Changes in Accounting Policies" section of this MD&A.

> Baseline and consolidated basic earnings per share have been impacted by share buybacks we have undertaken over the past three years (2003 – 881,336 Common Shares; 2002 – 811,615 Common Shares; 2001 – 197,100 Common Shares).

Consolidated Quarterly Data

The unaudited quarterly financial data for 2003 and 2002 is shown below.

2003	Three Months Ended			
(in millions $, except earnings per share)	Mar. 31	Jun. 30	Sept. 30	Dec. 31
Operating revenues	207.9	214.1	212.1	210.6
Operating income	55.9	57.7	58.2	46.8
Net income	24.4	24.1	24.5	12.8
Earnings per share	0.39	0.38	0.39	0.20
Diluted earnings per share	0.38	0.38	0.39	0.20

2002		Three Months Ended		
(in millions $, except earnings per share)	Mar. 31	Jun. 30	Sept. 30	Dec. 31
Operating revenues	290.4	216.6	210.7	209.6
Operating income	28.9	53.9	58.2	44.7
Net income	17.3	110.9	22.2	12.1
Earnings per share	0.27	1.72	0.35	0.19
Diluted earnings per share	0.27	1.71	0.34	0.19

As noted in the three-year review, excluding the impact of Bell Intrigna, Bell West and the charges associated with our restructuring initiatives, our overall performance tends to deliver relatively consistent and stable results, with limited variability on a quarterly basis.

RESULTS OF OPERATIONS

Earnings Per Share ($)

For the years ended December 31	2003	2002	% change
Consolidated EPS	1.36	2.53	(46.2)
Gain on Bell West transaction	–	(1.39)	n/m
Impact from Western operations	0.39	0.52	(25.0)
Restructuring charge	0.05	0.09	(44.4)
Goodwill revaluation	0.03	–	n/m
Baseline EPS (continuing operations)	1.83	1.75	4.6

Consolidated EPS were $1.36 in 2003, compared with $2.53 in 2002. Consolidated EPS were considerably higher in 2002 due to our recognition of a one-time $1.39 per share gain from the Bell West transaction. The recognition of this gain was triggered by our ownership level moving from 66.67% of Bell Intrigna to 40% of Bell West. Excluding this gain, growth in 2003 consolidated EPS reflects lower losses from our Western operations, growth in the baseline business, share buybacks and lower restructuring charges. The improvements in 2003 consolidated EPS were partly offset by higher debt charges, stock option and amortization expenses.

The impact from our Western operations decreased from ($0.52) per share in 2002 to ($0.39) per share in 2003. Prior to April 11, 2002, we consolidated Bell Intrigna's revenues and expenses in our financial results. On this date, we

began accounting for our 40% ownership interest in Bell West on an equity basis. Our 2003 results include our 40% share of Bell West's losses for the twelve months ended December 31st, while the 2002 impact from Western operations includes the consolidated results for the period from January 1, 2002 to April 10, 2002, and our 40% share of Bell West's net losses for the balance of the year.

In support of our ongoing focus on operational efficiency, we undertook a restructuring initiative in the fourth quarter of 2003. As a result, we recorded charges in the amounts of $0.05 per share associated with workforce reductions, and $0.03 per share for the revaluation of goodwill associated with our e-business operations. These charges compare to a $0.09 per share restructuring charge that we incurred in 2002.

In 2003, baseline earnings per share from continuing operations rose by 4.6% to $1.83. This increase is attributable to growth in the baseline business, which was partly offset by higher debt charges, stock option and amortization expenses.

EBITDA

(in millions $)	2003	2002	% change
Consolidated EBITDA	443.3	410.1	8.1
Impact from Western operations	–	19.1	n/m
Restructuring charge	5.1	10.0	(49.0)
Baseline EBITDA (continuing operations)	448.4	439.2	2.1

Consolidated EBITDA increased by $33.2 million or 8.1% to $443.3 million. These results reflect growth in the baseline business, and the exclusion of Bell Intrigna's operations from our financial results effective April 11, 2002. Baseline EBITDA from continuing operations climbed 2.1% to $448.4 million. This improvement was mainly due to revenue increases in our wireless and Internet services, along with improvements in operational efficiency.

Total Operating Revenues

(in millions $)	2003	2002	% change
Baseline	844.7	835.1	1.1
Bell Intrigna	n/a	92.2	n/m
Consolidated	844.7	927.3	(8.9)

Total operating revenues decreased by 8.9% to $844.7 million in 2003. This decline is attributable to our adoption of the equity method of accounting for our ownership interest in Bell West effective April 11, 2002, which was partly offset by modest growth in baseline revenues, which improved by 1.1%.

Baseline Revenues

(in millions $)	2003	2002	% change
Local	368.1	373.5	(1.4)
Long distance	189.0	205.5	(8.0)
Wireless	159.4	137.4	16.0
Internet	44.8	36.0	24.4
Directory	33.1	32.3	2.5
e-business	21.7	23.6	(8.1)
Miscellaneous	28.6	26.8	6.7
	844.7	835.1	1.1

"By making strategic investments in our network, MTS is able to deliver the services our customers want today, while building a strong platform for the development of future services and revenues."

Kelvin A. Shepherd, P.Eng.
Vice-President Network Services & Chief Technology Officer
MTS Communications Inc.

Revenues from baseline operations increased $9.6 million or 1.1% to $844.7 million. This reflects strong gains in our wireless and Internet businesses, together with increases in revenues from directory and MTS TV services. These higher growth operations were offset by lower long distance, local service and e-business revenues.

Baseline Revenues

Local Services

(in millions $)	2003	2002	% change
Revenues	368.1	373.5	(1.4)

Local services revenues include basic voice connections for residential and business customers, the access component of data services for business customers, enhanced calling features (such as Call Answer, Call Display, Call Waiting, and 3-Way Calling), payphones and wholesale revenues from services we provide to competitors. Revenues from local services also include contribution revenue. In 2003, local service revenues declined by 1.4% to $368.1 million. This minor decrease reflects changes in market conditions, competitor services regulation, and high-cost serving area regulation. Each of these is discussed below.

> **Changing Market Conditions** Local revenues from business customers decreased slightly because of a reduction in network access services ("NAS"), lower pricing, and competitive losses. Business NAS decreased by 1.1% in 2003, reflecting customer migration to other communications services and losses resulting from competition. Local revenues from residential customers decreased marginally, resulting from reduced NAS. We experienced a 0.3% reduction in residential NAS, which is consistent with changing customer preferences that are occurring across the industry as consumers migrate from traditional wireline to other services we offer, including high-speed Internet and wireless alternatives. Service disconnections resulting from non-payment also contributed to the residential NAS attrition. However, the negative impacts flowing from lower NAS were more than offset by increased subscriptions to other MTS offerings. As shown in the table on the next page, our total access services grew by 3.6% last year.

Access Services

	2003	2002	% change
NAS			
Residence	450,876	452,102	(0.3)
Business	250,104	252,814	(1.1)
Customers			
Wireless	255,657	234,062	9.2
Consumer high-speed Internet	77,643	61,628	26.0
Consumer dial-up Internet	52,077	55,926	(6.9)
MTS TV	8,693	200	n/m
Total Access Services	1,095,050	1,056,732	3.6

> **Competitor Services Regulation** In *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34 ("Decision 2002-34"), the CRTC expanded the number of services that we are required to provide to competitors, including a new competitive service called Competitive Digital Network Access ("CDNA"). The CRTC requires that these services be provided at cost plus a mark-up of 15%. In *Competitor Digital Network Access service proceeding*, Telecom Public Notice CRTC 2002-4, the CRTC established interim rates for CDNA service, which are approximately 40% of the previous retail digital network access rates. A CRTC decision finalizing CDNA rates is expected by June 2004. The prices of other MTS interconnection services used by competitors were lowered during 2003 as a result of revised cost studies initiated by the CRTC. These price changes primarily affected the charges for Direct Connect Service, Access Tandem Service and Primary Interexchange Carrier.

> **High-cost Serving Area Regulation** We are obligated by the CRTC to provide local phone service in parts of the province at rates that do not cover the cost of the service. Accordingly, we receive a subsidy in support of local service in high-cost serving areas from a national fund to which we and all other telecommunications providers must contribute. In 2003, our contribution revenues were slightly lower than the previous year. These lower revenues were offset by a similar reduction in contribution expense.

Long Distance Services

	2003	2002	% change
Revenues (millions $)	189.0	205.5	(8.0)
Minutes (thousands)	1,115,692	1,219,005	(8.5)

Our long distance line of business includes both voice and data services. Long distance voice services allow residential and business customers to communicate with destinations outside the local exchange. We also offer teleconferencing and virtual networking to business customers. The data component of long distance includes numerous services related to data transmission. In 2003, long distance revenues

"By providing long distance services, facilities for the student dial-up modem pool and equipment maintenance services, MTS helps The University of Manitoba and its 27,000 students connect with networks and services around the world."

Gerry Miller
Executive Director, Information Services and Technology
The University of Manitoba

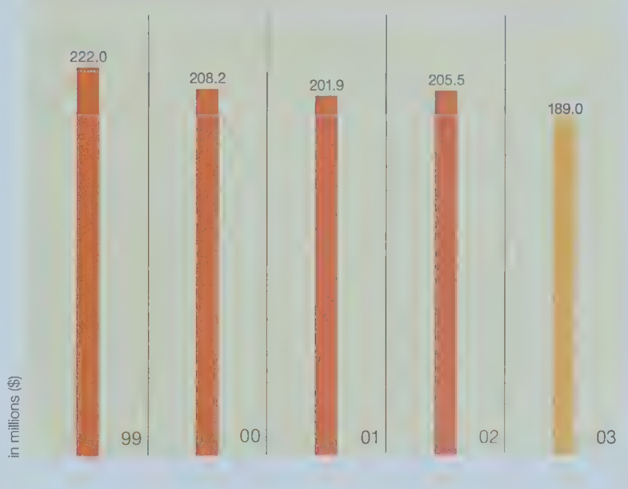
fell by 8.0% to $189.0 million. This is attributable to several factors, which led to revenue decreases in both the business and residential segments.

Long distance revenues from business customers were lower as a result of various factors, including the loss of two national call centres to competitors who offered pricing at very low levels that we were not willing to match; increased competitive pressures contributing to customer losses and lower pricing; as well as customers substituting long distance with other communications services, such as wireless and e-mail.

Long distance revenues from residential customers also declined in 2003. This is primarily due to competitive losses resulting from the increased presence of dial-around competitors. Reduced residential long distance revenues also reflect customer migration to lower priced plans, and wireless and e-mail substitution. These factors were offset in part, by the full year impact of price increases implemented in May 2002, together with the implementation of select residential price increases in our First Rate™ Unlimited plans in 2003, which included a change from $0.15 per minute to $0.20 per minute as well as a $2.00 increase in the maximum charge to $19.95 per month.

In addition, in the third quarter, demand declined for our cross-border wholesale long distance services because of the loss of a key customer. Revenues associated with this customer were approximately $7 million in 2003. More importantly, this long distance traffic was lower margin business, which means that the EBITDA impact was limited. During 2003, long distance results also were negatively impacted by CRTC-mandated price decreases for services provided to competitors.

Long Distance Revenues



Wireless Services

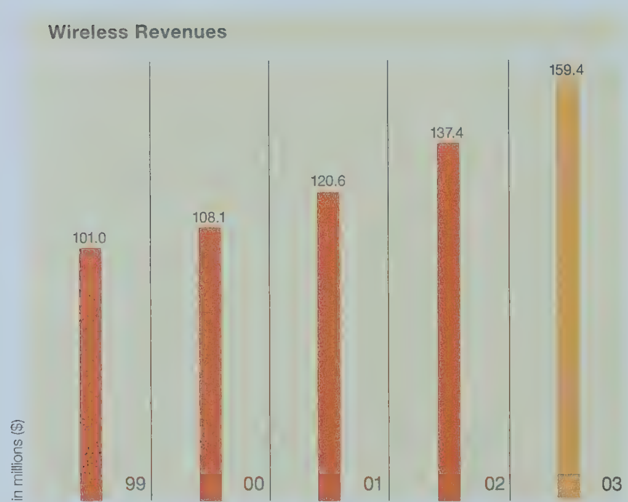
(in millions $)	2003	2002	% change
Revenues	159.4	137.4	16.0

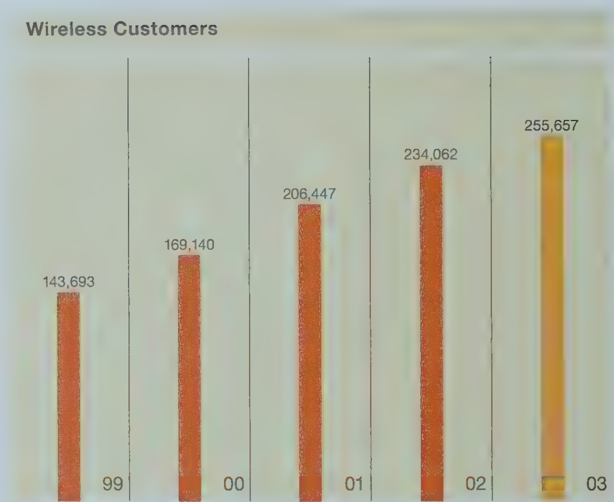
Our wireless portfolio consists of cellular, wireless data, paging and group communications services. As forecasted, we achieved double-digit growth in wireless in 2003, with revenues reaching $159.4 million, up $22 million or 16.0% from the previous year.

we are here

to lessen distances

Our advanced broadband network enables rural Manitoba physicians to use tele-medicine services for direct collaboration with specialists in major centres, accelerating diagnosis and treatment, and reducing travel costs for patients.

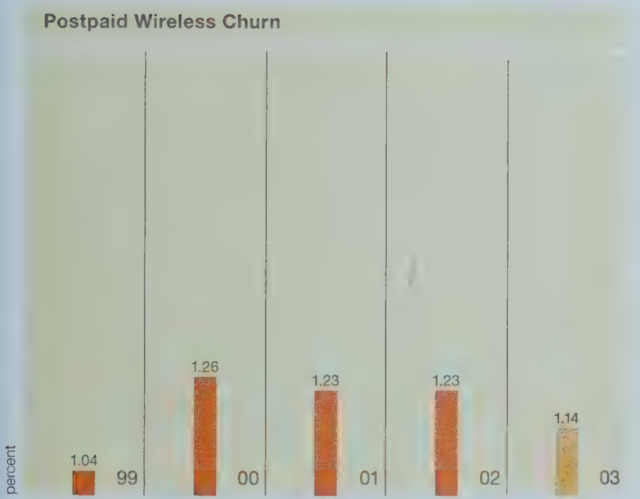




Continuing customer growth and strong improvements in average monthly revenue per customer ("ARPU") were the major reasons for this increase. On a year-over-year basis, our total customer base increased by 9.2% to 255,657 in 2003. We have experienced strong customer growth for the past several years, as indicated in the top right chart, and expect this trend to continue in the future.

In 2003, our wireless ARPU increased by 5.6% to $52.28. This is attributable to our marketing focus on value-added features and services for post and prepaid offerings, as well as positive pricing trends, which include the switch to per minute billing from per second billing in the third quarter of 2002. Also contributing to rising ARPU is the growing proportion of customers using digital services and features, which contributed to increased usage. Postpaid ARPU growth was positively affected by increases in system access and activation fees, price increases on enhanced services, as well as changes to consumer rate plans, which provided for a later start time for off-peak calling. We also delivered an improvement in prepaid ARPU as a result of increases in seasonal usage, and a reduction in prepaid expiry dates. On a national basis, we have consistently ranked among the leaders in blended ARPU (post and prepaid combined).

Churn refers to the percentage of our total base of customers who cancel their service each month. Churn directly impacts profitability. Our postpaid churn rate decreased in 2003 to 1.1% per month – an industry-leading level. Minimizing churn has always been an MTS strength in the wireless business.

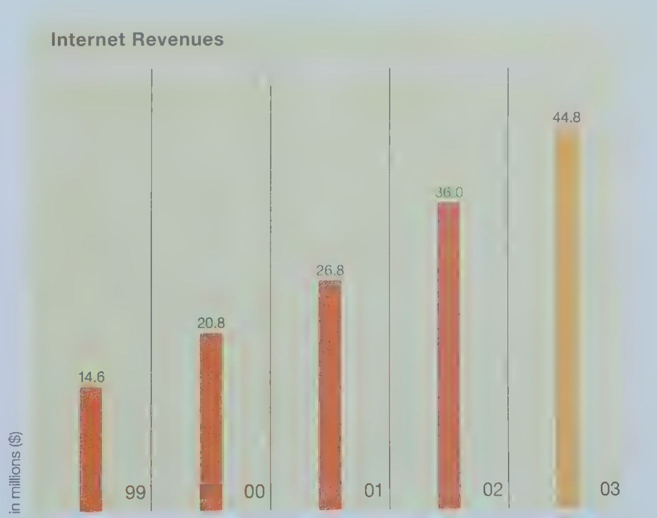


Internet Services

	2003	2002	% change
Revenues (millions $)	44.8	36.0	24.4
Customers			
High-speed	77,643	61,628	26.0
Dial-up	52,077	55,926	(6.9)
Total consumer	129,720	117,554	10.3

Overall, our solid position in wireless reflects high levels of customer satisfaction with our quality of service. We remain committed to driving profitable growth from our wireless network. At the end of 2003, we had extended 1xRTT capabilities to 95% of Manitoba's population. 1xRTT was first launched in the Winnipeg area in November 2002. 1xRTT functionality enables us to improve the capacity of our network for voice services, in addition to offering more data-intensive services. Some of these services include Mobile Browser™, two-way text messaging, Mobile e-mail and Internet access. In 2004, our 1xRTT capabilities will support the introduction of picture messaging and WAP 2.0 – a standard which provides colour and enhanced messaging for Internet access over a cellular phone.

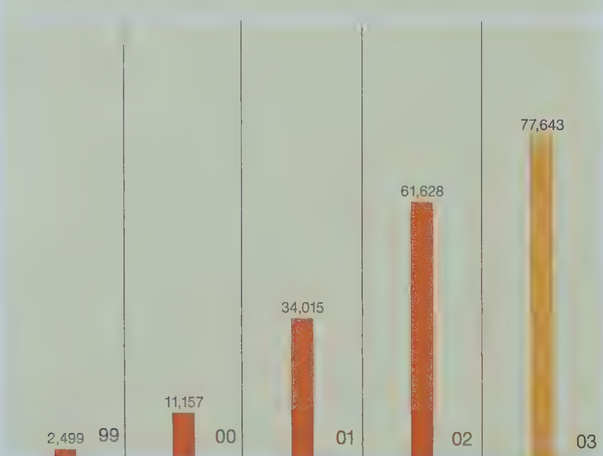
We offer dial-up and DSL high-speed Internet service to residential and business customers. As a result of strong customer growth driven by increased penetration and market share gains, 2003 was an excellent year for Internet services, with revenues rising to $44.8 million, representing a 24.4% annual increase. This reflects growth in the customer base and improvements in average revenue per customer. This increase in average revenue per customer is attributable to the diminishing impact of high-speed promotional pricing as the customer base increased, and an increase in the promotional pricing offer for new high-speed subscribers.



Our overall consumer Internet base increased by 10.3% to 129,720 customers. We exceeded our year-end target of 76,000 consumer high-speed Internet customers, adding 16,015 net new customers during the year. As at December 31, 2003, MTS had an estimated 46% of the residential high-speed Internet market, representing a four-point market share gain since December 2002. In 2003, we also delivered strong double-digit growth of 41.2% in the business segment, finishing the year with 5,035 connections. We remain the leading service provider in the business segment.

In 2003, we continued the rollout of our broadband infrastructure throughout Manitoba, adding 35 additional communities by year-end. By December 31st, 79% of our access lines were enabled to provide MTS high-speed Internet service, which includes 96% of Winnipeg and Brandon.

High-Speed Internet Consumer Customers



Directory Services

(in millions $)	2003	2002	% change
Revenues	33.1	32.3	2.5

Directory revenues principally include our Yellow Pages™ and White Pages telephone directories. In addition to the large business segment, the Manitoba economy includes a broadly diversified medium and small business sector. Most of these companies utilize our Yellow Pages™ directory as a core component of their advertising strategy. With the strength of our Yellow Pages™ brand, competitive advancements continued to be limited in 2003. Revenues were up 2.5% to $33.1 million. This is attributable to an increase in pricing and sales achievements.

e-business Services

(in millions $)	2003	2002	% change
Revenues	21.7	23.6	(8.1)

Qunara Inc., our e-business subsidiary, is an e-business solutions provider delivering services to business markets. Qunara's portfolio includes security services, e-business and application services, and hosting services through its Internet Data Centre. Qunara reported revenues of $21.7 million in 2003, a decline of 8.1% from the previous year. Lower year-over-year performance is attributable to continuing weak demand for information technology services that have an e-business component. We took measures last year to minimize the impact of softer market conditions. We improved Qunara's profitability outlook by streamlining operations through workforce reductions. We rationalized its product portfolio to emphasize security and managed services – two areas where Qunara has competitive

"With its solid expertise in the managed services, data and IT security areas, Qunara customers will rest assured that their vital applications, information and networks remain secure, viable assets to their business operations."

Nicholas M. Curry
Acting President & Chief Operating Officer
Qunara Inc.

advantages in Canada. Over the longer term, we anticipate a recovery in market conditions which should positively impact Qunara's future performance.

Miscellaneous Services

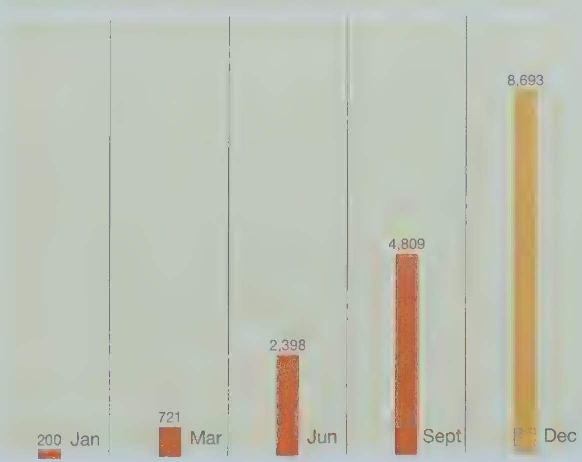
(in millions $)	2003	2002	% change
Revenues	28.6	26.8	6.7

Miscellaneous services primarily consist of security services, the sale and maintenance of terminal equipment (phone exchanges and hardware), and MTS TV. Revenues from miscellaneous services increased by 6.7% to $28.6 million in 2003. This growth is mainly attributable to the commercial launch of MTS TV, together with increases in revenues from our wholly owned subsidiary, AAA Alarm Systems Ltd. ("AAA Alarms"). Miscellaneous revenue growth was partly offset by lower year-over-year terminal equipment sales.

MTS TV is the newest addition to the MTS portfolio of services. In 2003, MTS TV services generated revenues of $1.3 million. We anticipate that digital TV will be an important contributor to our long-term growth. We began offering a commercial digital TV service in January 2003. MTS TV is offered across our broadband network platform, targeted at residential customers in Winnipeg. Our service is provided using VDSL technology (Very High-Speed Digital Subscriber Line). Our primary target is the current analog cable market in Winnipeg. MTS TV has several competitive advantages over other digital TV services, including the ability to deliver three simultaneous fully digital video signals along with high-speed Internet on a single set-top box.

The rollout of MTS TV proceeded extremely well through the year. This service has been well received in Winnipeg. By year-end, two significant goals had been achieved: we had extended service availability to 42% of the Winnipeg market and we had 8,693 installed customers – which is well in excess of our original 2003 target. Customer satisfaction levels also have been excellent. MTS TV is also stimulating demand for our high-speed Internet service. In 2003, 14% of MTS TV customers also added our high-speed Internet service when their MTS TV service was installed. By year-end, approximately 49% of our entire TV customer base were also high-speed Internet subscribers.

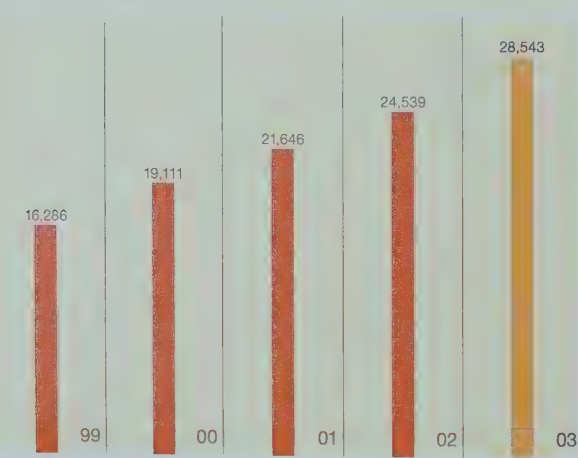
MTS TV 2003 Installed Customers



Consistent with our commitment to provide customers with one-stop shopping for their communications needs, we started bundling MTS TV and high-speed Internet in October. This loyalty plan gives MTS TV and DSL High Speed Internet customers a $10 discount off the regular monthly cost of the two services combined. This bundle is intended to drive customer and revenue growth, and contribute to customer retention going forward.

We deliver alarm services through AAA Alarms. This company provides security installation and monitoring to residential and small business customers in Manitoba and Alberta, which complements our telecommunications services business. The strong AAA Alarms brand, coupled with MTS's reputation as a full-service provider, offers the opportunity to grow market share in Manitoba and to expand security services into new geographic markets. This year, total alarm revenues were $9.5 million, an increase of 14.5% over 2002. AAA Alarms experienced strong double-digit customer growth of 16.3%, with a customer base of 28,543 at the end of the year. These results include our acquisition of an alarm services business in June 2003 for $1.6 million.

Alarm Services Customers



Operating Expenses

(in millions $)	2003	2002	% change
Baseline operations	**396.3**	395.9	0.1
Restructuring costs	**5.1**	10.0	(49.0)
Bell Intrigna	**–**	111.3	n/m
Amortization	**224.7**	224.4	0.1
Consolidated	**626.1**	741.6	(15.6)

Total consolidated operating expenses decreased 15.6% to $626.1 million. This favourable variance is mainly attributable to the exclusion of Bell Intrigna operations expense from our financial results effective April 11, 2002. Baseline operations expense essentially was unchanged compared with 2002 results. The results in 2003 reflect our continuing efforts to reduce expenses in the low growth traditional segments of the business to preserve margins and to shift these expense dollars to new growth areas like wireless, Internet and MTS TV. The 0.1% variance reflects increased costs to fund growth in newer lines of business, inflation, and stock option expense, as well as a lower year-over-year pension credit. Partly offsetting these factors were savings associated with our 2002 workforce reduction initiative, lower long distance and contribution expenses, and a decrease in Qunara's operations expense.

"MTS shares our vision of uniting the purchasing power of Manitoba First Nations, and as our preferred telecommunications provider, they supply our members with a wide variety of complete solutions."

President
First Nations Buying Group

During the fourth quarter, we incurred a pre-tax restructuring charge of $5.1 million for severance packages and other costs associated with eliminating 85 positions primarily from MTS Communications and Qunara. This workforce reduction is intended to contribute to our ongoing competitiveness, and will result in savings of approximately $6 million in 2004. In the previous year, we also undertook a workforce reduction initiative in the fourth quarter, recording a pre-tax restructuring charge of $10.0 million. This represented severance costs associated with eliminating 250 positions.

Amortization expense of $224.7 million is essentially unchanged from 2002 levels. The 0.1% increase reflects higher levels of baseline plant in service and higher amortization rates, which was partly offset by the elimination of Bell Intrigna depreciation expense effective April 11, 2002. Amortization of deferred wireless costs was largely unchanged in 2003 reflecting stable year-over-year cash acquisition costs of $18.5 million.

Equity Losses

(in millions $)	2003	2002	% change
Bell West impact	29.8	26.2	13.7

Our proportion of Bell West's net losses in 2003 totalled $29.8 million. In 2002, reported equity losses were lower at $26.2 million. This represented our share of Bell West's net losses from April 11, 2002 to December 31, 2002.

Subsequent Event – February 2, 2004 Bell West Put

On April 11, 2002, we entered into a shareholder agreement with Bell Canada, which, through certain liquidity provisions, confirmed the significant value that we created in Bell Intrigna. In accordance with the terms of that agreement, a put option was established that permits us to sell our ownership interest in Bell West to Bell Canada at a guaranteed floor value of $458 million plus any additional funding, together with an 8% return on incremental capital.

On February 2, 2004, we exercised this put option to sell our 40% ownership of Bell West to Bell Canada for approximately $645 million. Bell Canada must pay this amount by August 3, 2004. We continue to earn an 8% return on our cumulative funding to Bell West until we receive payment. This amount is included in the $645 million value.

With the exercise of the put option, we will recognize a one-time pre-tax gain of approximately $230 million on the sale of our investment in Bell West in the first quarter of 2004.

Debt Charges

(in millions $)	2003	2002	% change
Debt charges	33.2	29.5	12.5
Average weighted cost of debt	6.18%	6.60%	
Debt/total capital ratio	37.3%	34.7%	

Debt charges rose 12.5% to $33.2 million in 2003. This increase reflects higher interest expenses associated with higher levels of average outstanding long-term debt and commercial paper. We used our 2003 borrowings to fund our commitment to the Bell West business plan and to refinance maturing commercial paper.

Goodwill Revaluation

(in millions $)	2003	2002	% change
Goodwill revaluation charge	2.0	–	n/m

As part of our restructuring efforts, annual valuation tests, and the softer market conditions that continued in e-business in 2003, we revalued the goodwill related to Qunara. During the fourth quarter, we recorded a goodwill revaluation charge for Qunara of $2.0 million.

Income Tax

(in millions $)	2003	2002	% change
Income tax expense	71.7	71.6	0.1
Effective tax rate	45.5%	31.4%	

Our 2003 income tax expense totaled $71.7 million, representing an effective tax rate of 45.5%. The primary difference between our effective tax rate and the 2003 statutory rate of 40.1% is the inclusion of Bell West equity losses, which are taxed at the lower capital gains rate of 19%. Last year, our income tax expense was $71.6 million, and the corresponding tax rate was 31.4%. Our effective tax rate in 2002 was lower due to the impact of the gain that was recognized on the Bell West transaction. The one time pre-tax gain of $94.2 million was taxed at the lower capital gains rate of 19%. In addition, our change from consolidation to the equity method of accounting for Bell West required the recording of a one-time tax recovery of $14.1 million, which reflected the difference between the tax value and the book value of our Bell West investment.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows from Operations

(in millions $)	2003	2002	$ change
Cash flows from operating activities	324.2	209.8	114.4

Cash flows from operating activities refers to cash we generate from our normal business activities. Cash flows from operating activities were $324.2 million in 2003, compared with $209.8 million in 2002. This $114.4 million increase is mainly attributable to the timing of income tax payments. In 2002, our operating cash flows included income tax payments for two years, as our 2001 income taxes became due in the first quarter. This one-time anomaly contributed to cash used in changes in working capital of ($67.9) million in 2002. Cash from changes in working capital in 2003 was $21.5 million.

Prior to 2001, we did not have to pay income tax expense. 2001 marked the completion of MTS's four-year transition to full taxation. This process began in 1997 when MTS became a taxable entity and created a tax shield resulting from contributions to our pension plan. As this tax shield was utilized and various corporate entities became taxable, income tax increased.

"As we grow across Canada, MTS has provided a complete range of advanced services to fit our diverse needs. Their affordable solutions have improved our communications capabilities and are extremely beneficial to APTN."

Chief Executive Officer
APTN (Aboriginal Peoples Television Network)

Higher cash flows from operating activities in 2003 also reflect the fact that we discontinued the consolidation of Bell Intrigna's operations in our financial results effective April 11, 2002. The year-over-year improvement is also partly attributable to growth in baseline cash flows, which is slightly offset by pension plan funding of $9.6 million in 2003 (2002 – nil).

Investing Activities

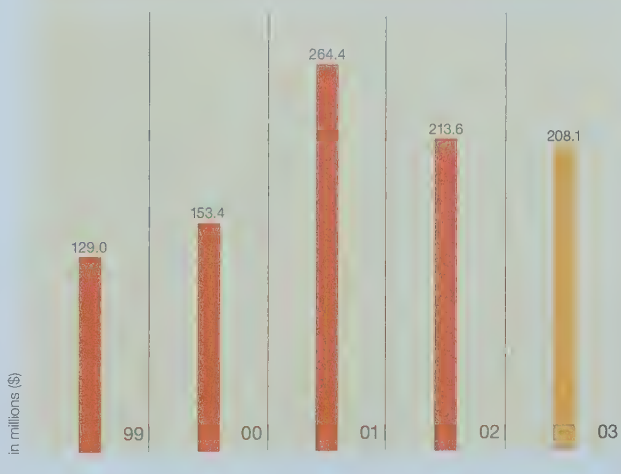
(in millions $)	2003	2002	$ change
Cash flows used in investing activities	(288.0)	(301.9)	13.9

Investing activities represent cash used for acquiring, and cash received from disposing of, long-term assets and other long-term investments. In 2003, we used $288.0 million for investing activities, which is $13.9 million lower than 2002 levels. Effective April 11, 2002, we adopted the equity method of accounting for Bell West. The year-over-year reduction in investing activities is primarily attributable to the fact that 2002 investing activities include the consolidation of Bell Intrigna's capital expenditures to April 11, 2002 in the amount of $8.6 million, and funding provided to Bell West of $77.6 million for the balance of the year. In 2003, our investing activities include funding to Bell West of $80.0 million. The year-over-year decrease also reflects lower baseline capital expenditures, which was slightly offset by the acquisition of an alarm monitoring business for $1.6 million.

Capital Expenditures

Telecommunications is a capital-intensive business. We continue to invest in our core operations to ensure success in creating long-term value for our shareholders. In 2003, our baseline capital expenditures were $208.1 million, consistent with our forecast capital expenditures of approximately $210 million. A key focus of our capital program in 2003 was the continued investment in broadband services, and specifically MTS TV, which represented $34 million in 2003. In 2002, our baseline capital expenditures were $213.6 million.

Baseline Capital Expenditures

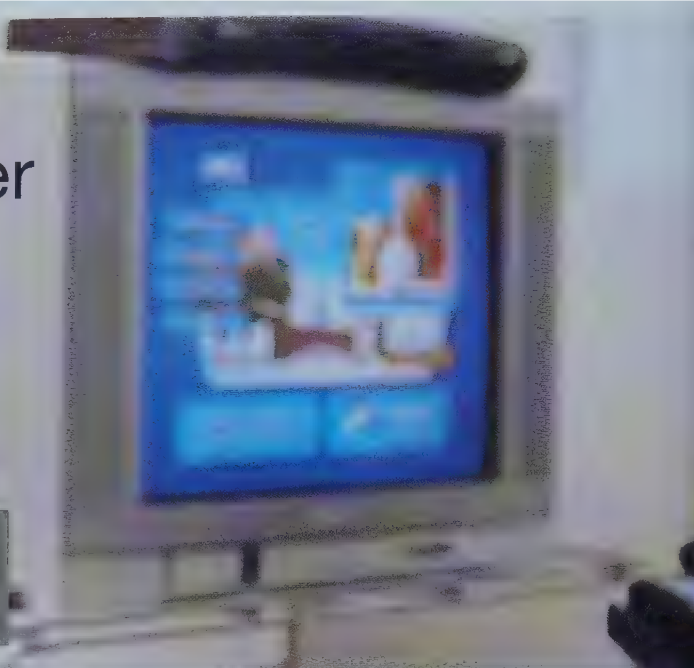


Free Cash Flow

(in millions $)	2003	2002	$ change
Baseline	35.6	31.1	4.5
Consolidated	(44.4)	(76.8)	32.4

we are here

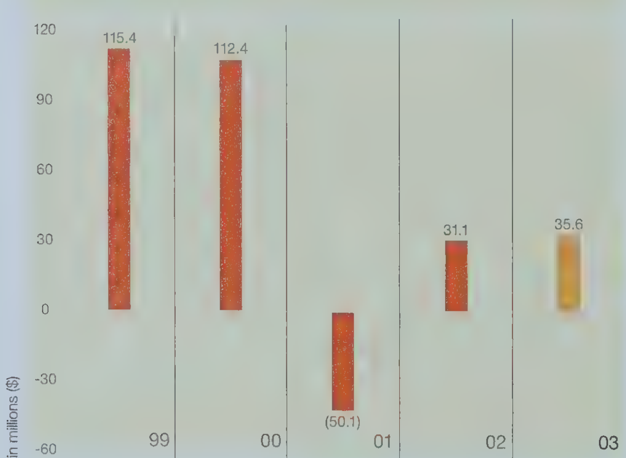
to deepen customer relationships



Our strong bond with our customers serves as a profitable avenue for MTS to deploy new service offerings, increase our share of wallet, and preserve our strong market position.

Free cash flow is discretionary funds that we have available for purchasing assets, increasing dividends, undertaking share buybacks or retiring debt. Our baseline operations continue to be a consistent generator of cash. In 2003, baseline operations generated free cash flow of $35.6 million, representing a 14.5% improvement over the previous year. This reflects growth in baseline cash from operating activities, and a decrease in baseline capital expenditures, which were partly offset by an increase in dividends and investments.

Baseline Free Cash Flow



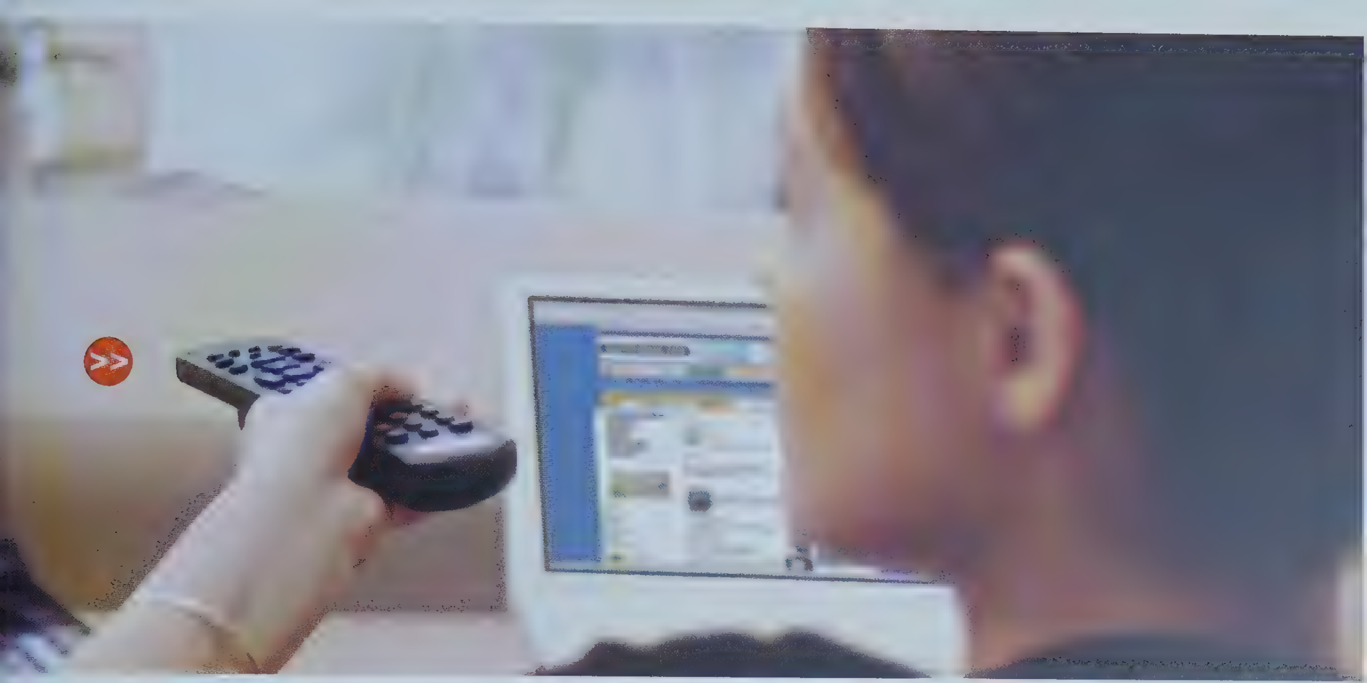
On a consolidated basis, 2003 free cash flow was ($44.4) million reflecting funding to Bell West of $80 million. All of our funding to Bell West has been recovered through the exercise of the put option together with an 8% return. Consolidated free cash flow improved significantly in 2003, primarily due to the reduction in the impact of our Western operations and growth in baseline cash flows, which were partly offset by an increase in dividends.

Financing Activities

(in millions $)	2003	2002	$ change
Cash flows (used in) from financing activities	(31.0)	59.3	(90.3)

Financing activities refer to actions we undertake to fund our operations through equity capital and borrowings. In 2003, cash flows used in financing activities were $31.0 million. Our most significant cash outflows were dividend payments and share buybacks. In the second quarter, we increased our quarterly dividend rate by 13.6% to $0.25 per share. Cash outflows associated with dividend payments in 2003 totaled $59.1 million (2002 – $52.6 million). During 2003, we also purchased for cancellation 881,336 Common Shares for cash consideration of $30.8 million (2002 – 811,615 Common Shares for $24.7 million). In total, we returned $89.9 million to shareholders during the year.

In 2003, we issued net notes payable in the amount of $57.0 million. The proceeds from these notes funded our investment in Bell West and short-term working capital requirements. In 2002, we issued long-term debt of $145.0 million, which we used to fund our 2001 income tax payment, Bell West, and to refinance maturing debt.



Credit Facilities

(in millions $)	Capacity	Utilized as at December 31, 2003
Medium term note program (renewed June 2003)	350.0	–
Commercial paper program	150.0	68.0
Operating line of credit	50.0	–
Total	550.0	68.0

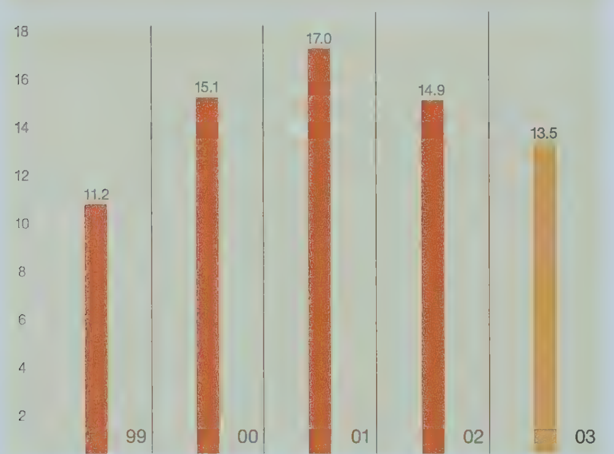
We have arrangements in place that allow us to access the debt and commercial paper markets for funding when required. Borrowings under these facilities are typically used to fund new initiatives, refinance maturing debt, and manage cash flow fluctuations. We renewed our medium term note program in June 2003. This enables us to periodically issue medium term notes up to an amount of $350 million until July 2005. As of December 31, 2003, no medium term notes had been issued under this program. In February 2003, we increased our commercial paper program to $150 million, under which $68.0 million was outstanding at December 31st. This program enables us to add a short-term component to our debt structure where appropriate. During the second quarter of 2003, we also renewed our $50 million operating line of credit. This facility was not utilized as of December 31, 2003.

Credit Ratings

	2003	2002
DBRS – Commercial paper	R-1 (low)	R-1 (low)
DBRS – Senior debentures	A (low)	A (low)
S&P – Commercial paper	A-1 (Mid)	A-1 (Mid)
S&P – Senior debentures	A	A

We have very strong credit ratings. This enables us to borrow at attractive interest rates. Two leading rating agencies, Dominion Bond Rating Service ("DBRS") and Standard & Poor's ("S&P") analyze MTS and assign ratings based on their assessments. Our favourable credit ratings are due to continuing balance sheet strength, high levels of profitability, and our leading market position in Manitoba. In February 2004, DBRS affirmed its "A (low)" rating on MTS's senior unsecured debentures. In November 2003, S&P affirmed its "A" rating on our long-term corporate debt, and revised our outlook from stable to positive, reflecting our ability to sustain strong operating performance and attractive credit ratios, such as our EBITDA/Interest coverage ratio as illustrated on the next page:

Baseline EBITDA/Interest Coverage Ratio (Continuing Operations)



Our commercial paper ratings were also affirmed as "R-1 (low)" by DBRS and as "A-1 (Mid)" by S&P, respectively.

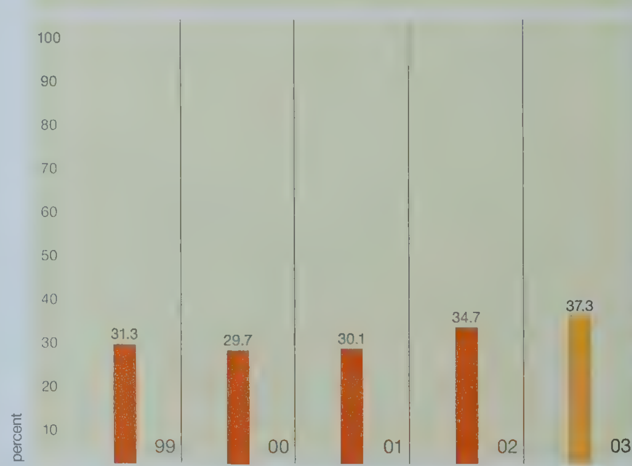
On January 28, 2004, S&P placed our "A" long-term corporate credit, senior unsecured debt, and medium term note programs on Credit Watch, following an announcement that our Board of Directors had received a proposal from a shareholder requesting that MTS place a resolution before its shareholders at the 2004 annual meeting of shareholders as to whether or not MTS should be converted to an income trust. Ratings appear on Credit Watch when an identifiable event occurs that could impact current credit ratings. S&P has indicated that our credit rating could be positively, negatively or neutrally affected, depending on the outcome of this development.

Capital Structure

(in millions $, at December 31)	2003	2002
Long-term debt and notes payable	529.3	472.3
Shareholders' equity	888.7	888.7
Total capitalization	1,418.0	1,361.0
Debt to capitalization	37.3%	34.7%

Our capital structure illustrates how much of our assets are financed by debt versus equity. At year-end 2003, our debt ratio was an industry-low 37.3%, which means that we have excellent financial strength and flexibility. Moreover, net of the Bell West put proceeds of approximately $645 million, we effectively are debt-free. Since December 2002, our debt ratio has increased marginally due to an increase in notes payable to fund commitments to Bell West. In accordance with our shareholder agreement with Bell Canada, all the funding we provide to Bell West is recovered with an 8% return.

Total Debt to Total Invested Capital



"Thanks to innovative solutions and outstanding customer service from MTS, our nationwide network of agents can always count on reliable transmission of their real time business interactions."

President & Chief Executive Officer
National Leasing

Outstanding Share Data

Authorized:

> Unlimited number of Preference Shares of two classes issuable in one or more series
> Unlimited number of Common Shares of a single class

Issued as of March 5, 2004:

Shares	Number of Shares	Book Value (in millions $)
Class A Preference	1,379,556	33.0
Common	61,520,053	552.5
		585.5

Stock options:

Options	Number of Options	Weighted Average Exercise Price
Outstanding	1,983,120	$ 28.07
Exercisable	951,188	$ 21.85

Contractual Obligations

The table below provides our contractual obligations as at December 31, 2003 for each of the five fiscal years ended thereafter. Our long-term debt consists of medium term notes. We issue medium term notes for general corporate and working capital purposes, for financing investments, and additions to property, plant and equipment. We rent buildings and construction and other equipment under operating leases. We enter into various long-term contractual commitments for services required in our operations, which are reflected in the table below as purchase obligations.

Financial Instruments and Off-Balance Sheet Arrangements

Foreign Currency Forward Contracts

Beginning in 2004, we use foreign currency forward contracts to manage the price of our U.S. dollar purchases. These instruments will be accounted for as a hedge of anticipated transactions and will not be recorded on our balance sheet. As at December 31, 2003, we did not have any foreign currency forward contracts.

In January 2004, we entered foreign currency forward contracts to purchase $8.0 million U.S. at an average exchange rate of 1.29. These contracts mature periodically over a nine-month period beginning in April 2004 and ending December 15, 2004. We have entered into forward contracts primarily to hedge purchases relating to our MTS TV service. We purchase set-top boxes and other related equipment from an American vendor. Entering into these forward contracts enables us to lock in the cost of these items at an attractive price, and eliminate risk associated with future exchange rate fluctuations.

Contractual Obligations

(in millions $)	2004	2005	2006	2007	2008	After
Long-term debt	75.0	60.1	48.1	106.5	89.7	81.9
Operating leases	6.3	5.5	4.2	2.2	1.6	n/m
Purchase obligations	31.9	18.6	14.2	13.4	8.6	n/m
Total	113.2	84.2	66.5	122.1	99.9	81.9

Guarantees

We have provided guarantees totaling a maximum of $48 million, which pertain to a performance bond and a labour and material payment bond issued to Bell West in respect of its contractual commitment with the Government of Alberta relating to the construction of a high-speed telecommunications network. We have guaranteed $3.9 million of a line of credit supporting an irrevocable letter of credit issued by Bell West. At the closing date of the sale transaction of Bell West, our obligations respecting these guarantees will be terminated.

Other Financial Arrangements

Employee Future Benefits

We have a contributory defined benefit best average pension plan (the "Pension Plan"), which covers the employees of Manitoba Telecom Services Inc., MTS Communications Inc., MTS Media Inc., and Manitoba Telecom Services International Inc. The Pension Plan provides pensions based on length of service and best average earnings. The Pension Plan is funded as determined through periodic actuarial valuations. Contributions reflect actuarial assumptions regarding salary projections and future service benefits. We also provide supplemental pension arrangements and other non-pension employee future benefits that are unfunded with the exception of the long-term disability plan for which we have dedicated assets set aside to fund benefits. These assets are recorded on our financial statements.

In 2003, we recognized a defined benefit pension plan credit of $5.8 million (2002 – $7.6 million), which is comprised of a current service cost (net of employee contributions) of $13.7 million (2002 – $11.6 million), interest on the accrued benefit obligation of $63.0 million (2002 – $63.0 million), an expected return on plan assets of $71.6 million (2002 – $71.3 million), and the amortization of the transitional asset of $10.9 million (2002 – $10.9 million).

Transactions with Related Parties

We have transactions with related parties in the normal course of our operations, at prevailing market prices and under normal trade terms. We are subject to significant influence by Bell Canada due to its ownership of our Common Shares and Class A Preference Shares, as well as its representation on our Board of Directors. Bell Canada holds 21.7% of our issued and outstanding shares, and holds three seats on our 14-seat Board of Directors.

We have an operating alliance with Bell Canada, which gives us the distribution rights in Manitoba for products and services offered by Bell Canada. These operating arrangements also provide us with access to its intellectual property, national infrastructure, business processes and expertise, and enable us to lower capital costs by leveraging Bell Canada's buying power.

Related parties include Bell Canada, its parent, subsidiaries, and significantly influenced affiliates (collectively, "Bell"). During 2003, we made purchases of goods and services from Bell totaling $17.6 million and sales of goods and services of $11.0 million. At year-end, the net amount due from Bell totaled $0.3 million. We also pay to, and receive amounts

"As part of MTS's commitment to outstanding customer service, we ensure that we have professional, highly-trained employees to meet our customer needs."

Patricia A. Solman, CA
Vice-President Customer Care
MTS Communications Inc.

from, Bell for transiting and terminating long distance traffic. These amounts are in the normal course of operations and are at prevailing market prices.

KEY ACCOUNTING ESTIMATES AND CHANGES IN ACCOUNTING POLICIES

Key Accounting Estimates and Assumptions

The preparation of our consolidated financial statements in accordance with Canadian GAAP requires us to make estimates and assumptions. We make these estimates and assumptions based on reasonable methodologies, established processes and comparisons to industry standards. We continuously evaluate these estimates and assumptions. These estimates and assumptions rely on the use of professional judgment. Because professional judgment involves inherent uncertainty, actual results could differ from our estimates. Our estimates, assumptions and methods have been applied consistently.

Employee Future Benefits

The actuarial assumptions used in determining MTS's accrued benefit obligations for December 31, 2003 include a discount rate of 6.50% (2002 – 7.00%) for pension liabilities and 6.25% (2002 – 6.75%) for the non-pension employee future benefits liabilities, expected long-term rate of return on plan assets of 7.50% (2002 – 7.50%), and a rate of compensation increase of 3.50% (2002 – 3.75%). A change in these assumptions could affect the determination of pension expense and deferred employee benefits.

Income Taxes

When recognizing current and future income tax assets and liabilities, we make estimates and judgments with respect to the outcome of ongoing tax audits and the realization of tax loss carry forwards and other temporary differences. As a tax paying entity, we are subject to reviews by Canada Customs and Revenue Agency (the "CCRA"). CCRA audits are currently underway for 1997, 1998, and 1999. The 1997 audit includes a review of the transaction that converted MTS from a provincially-owned Crown corporation to a publicly traded share capital corporation. An outcome of these CCRA tax audits that is different than expected could affect income tax expense, cash flows and the amounts or classification of future tax assets and liabilities.

Property, Plant and Equipment

We make estimates regarding useful lives and amortization rates of property, plant and equipment based on a continuing program of engineering studies. These estimates are reviewed at least annually, and more often, if required. For the year ended 2003, our composite amortization rate was 7.8% (2002 – 7.5%). A change in amortization rate would affect the amount of amortization expense and accumulated amortization.

Useful Lives of Deferred Costs

Deferred costs are amortized on a straight-line basis over our best estimate of the future period of benefit. We amortize our deferred wireless activation costs over the estimated period of benefit, which is normally two years, while alarm installation

costs are amortized over ten years. We review these estimates on an annual basis, with consideration given to customer churn, industry standards and other relevant business factors.

Accounts Receivable

As we expect that a certain portion of our receivables from customers will not be collected, we maintain an allowance for doubtful accounts. Our estimate is based on our policy to provide allowances for accounts receivable greater than 90 days. If economic conditions or actual results differ from our expectations, we adjust our allowance for doubtful accounts and bad debt expense accordingly. A change in our estimate would impact bad debt expense and accounts receivable.

Goodwill

We test the valuation of goodwill on an annual basis or earlier when events or changes in circumstances indicate that goodwill might be impaired. In the fourth quarter of 2003, we completed our annual valuation tests. As a result, we recognized a $2.0 million revaluation charge to reduce the carrying value of goodwill for Qunara to its fair value. The results of other tests of goodwill indicated that the fair values of goodwill were higher than the carrying values as at December 31, 2003. A change in estimates could impact the carrying value of goodwill.

Changes in Accounting Policies Including Initial Adoption

Our 2003 consolidated financial statements have been prepared using the same accounting policies that we used in 2002, except for the change in accounting policy relating to stock options.

Stock-Based Compensation

We adopted the fair value method of accounting for stock options and began recognizing compensation expense related to stock options effective January 1, 2003. We applied this change in accounting policy retroactively, and have restated the 2002 comparative financial statements to show the effect on the change on net income, retained earnings, and contributed surplus in the amount of $1.3 million. In 2002, we used the intrinsic value method of accounting for stock options granted to employees, which did not require expense recognition.

In 2004, we adopted the following changes to our accounting policies:

AAA Alarms Accounting Policy

Effective January 1, 2004, we changed our accounting policy for deferred alarm installation costs to proportionately match the costs of alarm installation with the installation and monitoring revenues earned from the customer. Previously, we amortized 100% of the alarm installation costs. We will continue to amortize deferred costs over the estimated period of benefit of ten years. We will apply this change in accounting policy retroactively and restate prior period balances, beginning in the first quarter of 2004.

Foreign Currency Forward Contracts

Commencing in 2004, we use foreign currency forward contracts to manage foreign exchange exposure, which arises in the normal course of business operations. We apply

"MTS network platforms and customer support help to ensure smooth, efficient functioning of our back office operations, allowing us to provide the highest quality service to our more than 32,000 Manitoba shareholders."

President and Chief Executive Officer
Crocus Investment Fund

hedge accounting for foreign currency forward contracts that are designated and effective as hedges for foreign currency denominated commitments. Our policy is to formally document the relationship between a hedging instrument and a hedged item, as well as the nature of the specific risk exposure being hedged and the intended term of the hedging relationship. The effectiveness of the hedge is assessed at its inception and throughout the term of the hedge. Gains and losses on forward currency contracts that qualify for hedge accounting are recognized in income in the same period that gains and losses on the underlying hedged transactions are recognized. We do not utilize derivative financial instruments for any speculative purposes.

RISKS AND UNCERTAINTIES

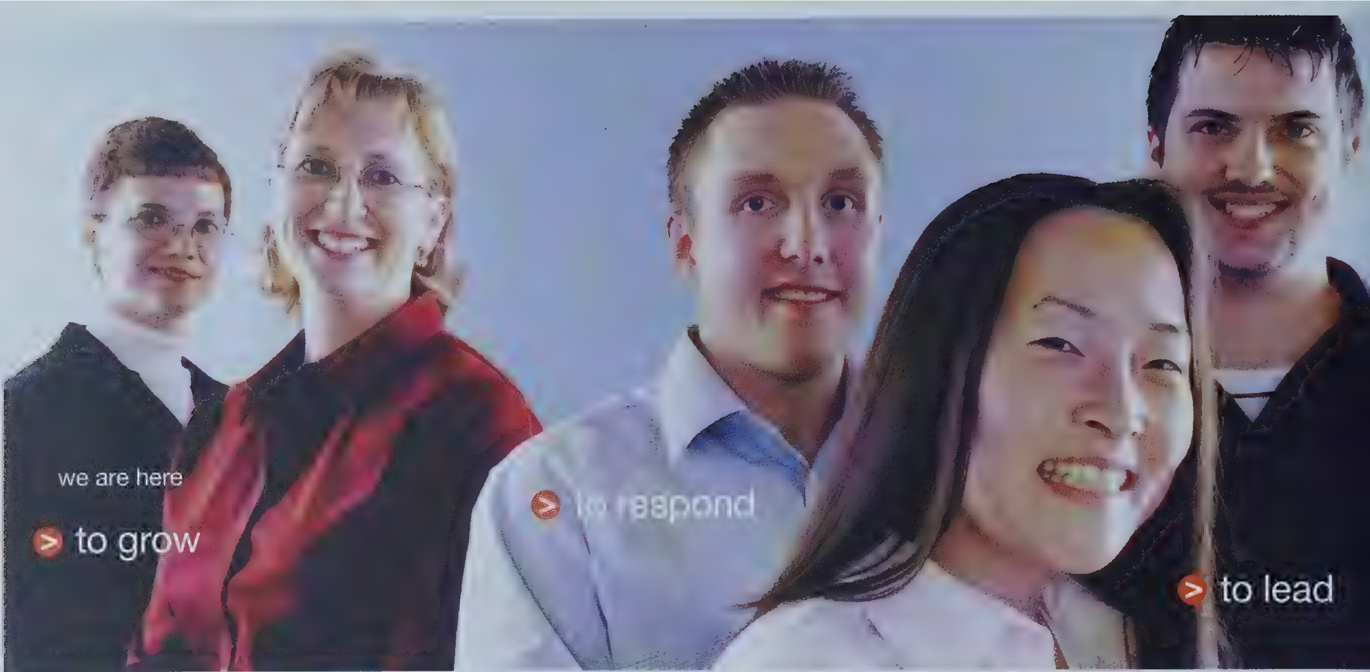
Our challenge is exceeding shareholder expectations for continued growth in the face of increasing and diverse competition, limited growth opportunities in the Canadian marketplace, and a generally unfavourable regulatory climate. Risks and uncertainties in the business include the following:

Regulatory and Policy Decisions

Regulatory decisions continue to favour our competitors by providing further discounts, wholesale pricing and access to the networks of the incumbent local exchange carriers ("ILECs"). The CRTC continues to provide competitors with access to key components of our network infrastructure and discounted pricing, and generally to issue rulings that enhance the market position of our competitors. Rules of engagement are not symmetrical in the converging telecommunications and broadcast industries. As technology increasingly permits the delivery of ubiquitous services by providers in the telecommunications and cable sectors, uniform regulation that treats all service providers equally will be important to competitive success. Future federal government policies that relax foreign ownership restrictions, which will open the Canadian marketplace to new competitors with strong resources, could negatively impact our business.

> **Proposed Price Floor Restrictions** In December 2003, the CRTC released a public notice which has a potentially significant impact on our ability to competitively price any bundle of services that contains local services. If the CRTC implements its proposed price floor restrictions, the result would be higher prices for customers and a reduction in our flexibility to develop and price service bundles that include local service as a component of the bundle. The resolution of this issue is not expected until mid-2004 or later.

> **Price Cap Deferral Account** We are currently subject to price cap regulation as established by the CRTC in Decision 2002-34. This regulation is effective for a four-year period that began on June 1, 2002. It requires certain prices to be adjusted annually by an amount equal to inflation less a productivity factor of 3.5%. These amounts are accumulated in a "regulatory deferral account". In addition, prices for certain of our capped services continue to include a component for some time-limited price increases the CRTC



previously had granted. These amounts also accumulate in the regulatory deferral account. As at December 31, 2003, we estimate our deferral account commitment to be approximately $10 million.

The CRTC has indicated the general uses of the deferral account. The deferral account can be used to offset CRTC mandated price decreases for services provided to competitors, to recover service improvement plan costs in non high-cost serving areas, and to mitigate the effects of any local residential price increases and other initiatives that may be beneficial to residential customers. The CRTC has indicated that it intends to consider the disposition of deferral account balances in a proceeding to be initiated in 2004.

> **Regulatory Symmetry** In November 2003, Bell Canada filed an application requesting the CRTC to launch a public hearing concerning the establishment of regulatory symmetry between companies regulated under the *Telecommunications Act* (Canada) and the *Broadcasting Act* (Canada). If the CRTC initiates a public proceeding and issues a decision to more closely align the broadcasting and telecommunications regimes, our ability to compete within the television, Internet and local telephony marketplace could be enhanced.

> **Review and Vary Application** In 2003, we filed an application with the CRTC which proposed that certain high-cost exchanges that are currently in "Band D" be reclassified into a new "Band F". We also requested a monthly subsidy amount of $10.14 per residential network access service in Band F to be sourced from the CRTC's national contribution fund. In a related decision, the CRTC approved, on an interim basis, a monthly subsidy of $4.05 per residential network access service in Band F. Following an analysis of the CRTC's decision, we filed an application with the CRTC to review and vary this decision. Our application contains information respecting costs associated with the provision of services in Band F that justify a higher subsidy request. We are optimistic that our request will be approved in 2004.

> **Foreign Investment Review** In January 2003, the federal government began a review of foreign ownership restrictions for telecommunications carriers including MTS. The House of Commons Industry Committee began hearings to debate whether the current 46.5% foreign ownership restriction should be eased to give carriers greater access to capital markets. On April 28, 2003, the Industry Committee tabled its report recommending the removal of minimum foreign ownership restrictions for telecommunications carriers and broadcast distribution companies. These recommendations conflict with a report made by the House of Commons Standing Committee on Heritage. No action on the Industry Committee's recommendations is expected prior to an anticipated federal election in 2004.

Changes in Competitive Conditions

Competition is expected to remain strong in 2004, with the potential to materially affect our performance. We expect the

strongest competitive threats to come in long distance, wireless, and Internet markets. In 2003, a new competitor entered the directory market. In the next six to eighteen months, we expect the incumbent cable provider to enter the local residential market, facilitated by voice over IP-based technology. Continuing strong competition is expected from both existing companies and new entrants, including national and international carriers, cable companies and alternative providers. We also anticipate stronger competition from restructured insolvent companies with lower cost structures and renewed financial backing.

Economic Fluctuations

A slowdown in the Canadian and global economy could impact our business, including reducing our access to low-cost investment capital. Any decline in economic growth and commercial activity may result in residential and business customers delaying purchases or discontinuing use of service. Slower economic conditions may also affect our ability to collect receivables from customers.

Technological Change and Displacement

Network technology continues to evolve at a pace that may enable new competitors to enter the market with increased flexibility, provide increased choice for customers, and speed the obsolescence of our core technologies. This could result in displacement of products and services by substitutes and create a potential for accelerated investment in our network evolution. Technological advancement also results in an increased risk of obsolescence of our property, plant and equipment.

Labour Agreements

A significant portion of our employees are unionized and are covered by collective agreements. These collective agreements have expiry dates ranging from February 2004 to January 2005. If we are unable to renew these collective agreements, this could negatively affect our business operations.

Alliance with Bell Canada

We currently have a number of operating arrangements with Bell Canada, which provide us with the distribution rights for certain products and services, access to intellectual property, business processes and other expertise, and the opportunity to leverage Bell Canada's buying power. A material change in our strategic alliance with Bell Canada could negatively impact our business by making it necessary to find alternate means to deliver certain services.

Shareholder Proposal

On January 27, 2004, we announced that our Board of Directors had received a valid proposal pursuant to section 131 of *The Corporations Act* (Manitoba) from a shareholder requesting that MTS place a resolution before its shareholders at the 2004 annual meeting of shareholders as to whether or not MTS should be converted to an income trust. If this resolution is approved, the Board of Directors will review this matter and, if considered appropriate, will bring a conversion proposal with specific terms to a subsequent shareholders meeting. The response of the Board of Directors to this shareholder proposal will be included in our 2004 Management Proxy Circular.

SOCIAL RESPONSIBILITY

We understand and value the important role our company has in community life throughout Manitoba. During 2003, we continued with our commitment – a long MTS tradition – of actively supporting organizations and causes important to all our stakeholders, including employees, shareholders and customers. This also supports strategies to advance the reputation of our brand in the market. We contribute to a wide range of social, cultural, educational and sports organizations throughout the province through direct program funding, in-kind contributions, and the volunteer efforts of our employees.

Environmental Commitment

Our concern for the community is also reflected in our continuing dedication to the principles set out in our environmental policy. This policy states that we are committed to conducting our business in a manner that reflects concern for the environment and supports the principles of sustainable development.

We have a long-standing and continuously updated environmental management system to function as a guide for environmental stewardship and compliance. This system reflects the vital importance that we place on protection of the environment and conservation of natural resources. Our environmental management system was developed based on international standards for environmental management. We continually monitor our operations to ensure compliance with all applicable environmental requirements. Our business operations do not generate significant waste products that would be considered a health or welfare concern under current legislative requirements.

OUTLOOK

We are projecting solid financial performance again in 2004 by continuing to execute our business strategy, which is to build upon our leadership position in Manitoba.

Our 2004 outlook assumes continuing consistent performance for the Manitoba economy, which is forecast to deliver growth in real Gross Domestic Product of between 2.5 and 3% this year. The following is our 2004 guidance for continuing baseline operations:

Baseline Operations	2004 Expectations [1]
EPS	6 to 8%
EBITDA	3 to 5%
Revenues	3 to 5%
Capital spending	$210 M
Free cash flow	$45 to $50 M

[1] Growth rates based on 2003 results from continuing operations.

Growth is expected from our high-margin foundation of telecommunications services, with particularly strong outlooks for wireless, Internet and digital TV. Revenues from traditional operations, including local, long distance and directory services on a combined basis, are forecast to be stable or to slightly decline in 2004 and for the foreseeable future.

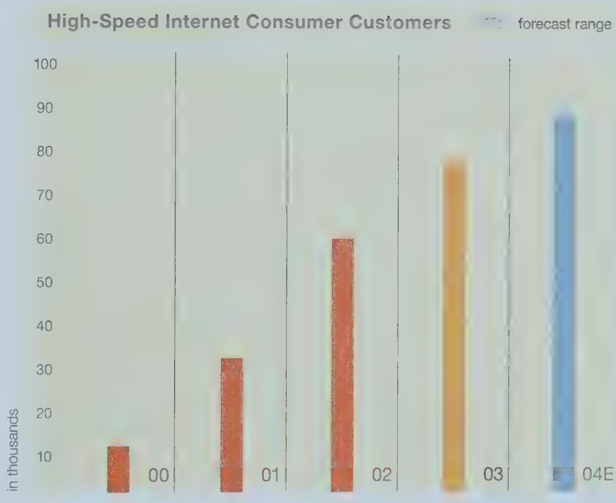
"MTS equipment and service allows us to provide customers and retailers, located in hundreds of remote communities across northern Canada and Alaska, with a single point of contact to our company."

President & Chief Executive Officer
The North West Company

The following is the outlook in select market segments:

Wireless Services: Double-digit revenue growth in wireless is expected, along with continuing strong gains in the customer base. Wireless penetration in Manitoba was approximately 32% at the end of 2003. This compares to the Canadian penetration rate of 40%, indicating significant growth potential for some time to come. High levels of ARPU and low churn will contribute to another strong year. Growth in data and content offerings and other new services that increase and exploit our 1xRTT network capabilities is expected to increasingly contribute to our ongoing success in this segment in 2004 and beyond.

Internet Services: Growth in the range of 14% to 16% in high-speed Internet customers will drive this business forward in 2004. Continued migration of dial-up customers to high-speed will form a portion of that growth. In 2003, we extended our broadband platform to more communities in the province, adding approximately 12,000 households and 1,500 businesses to our addressable market. At the end of 2003, we had surpassed our competitors as the market share leader. We expect to remain the market leader in this growing segment. Double-digit revenue growth is anticipated in 2004. Continuing strong competitive pressures are likely to limit opportunity for significant pricing increases in 2004.



Local and Long Distance Services: Excluding regulatory impacts, we expect marginally declining revenues in local and long distance services in 2004. We expect continuing but modest erosion in access services and market share arising from changing customer preferences, such as wireless substitution, and competitor alternatives. Competitive pressures and the ongoing commodification of long distance will keep pressure on margins in 2004. Residential IP-based service providers will become more visible in the future. However, we believe that the impact on local and long distance revenues will be immaterial in 2004, as providers continue to evolve quality of service and other difficulties that currently face this technology.

we are here

to move forward

We continued to upgrade our wireless network with 1xRTT technology, laying the foundation for a new generation of wireless tools, mobile applications and games.

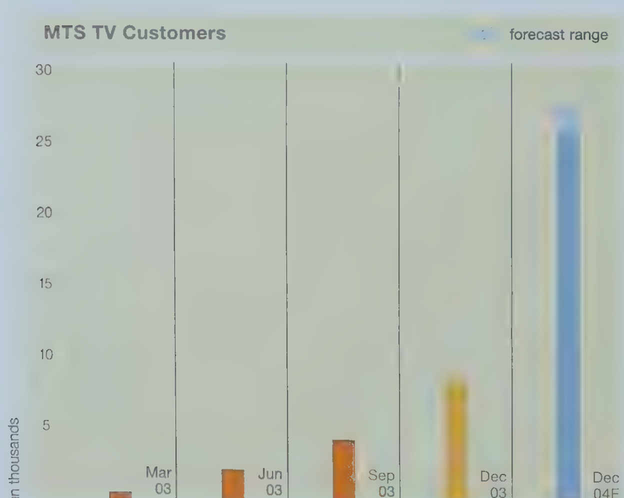
We pushed our wireless customer base through the 250,000 milestone, with revenues climbing strongly by 16%.

Wireless Customer Base

In the rapidly growing market for high-speed Internet services, we gained ground on our competitors, increasing our share of the residential high-speed market to 46%.

High-speed Internet

Digital TV Services: Strong demand in 2003 for MTS TV is a good indicator of what is expected in 2004. MTS TV will leverage our leading market position, brand recognition, customer care and back office capabilities to capture share in this growing $100 million market in Winnipeg. We are entering the market at a time when customers are looking to shift from analog to digital service, which positions us to capture business as customers upgrade. In addition, we are taking one more service to a base of customers with whom we have extensive and long-term relationships based on high levels of customer goodwill. We intend to keep pursuing this market opportunity prudently. In 2004, we expect revenues of $12 million to $14 million and to see the customer base increase significantly to more than 26,000 by year-end, which will keep us on track to achieve profitability in 2005.



In November of 2003, we were granted a video-on-demand ("VOD") license by the CRTC, which enables us to offer the latest in programming distribution. The introduction of pay-per-view and VOD services is expected to positively contribute to MTS TV revenue growth as the services are introduced in 2004.

e-business: As market demand has decreased significantly from prior years, we do not forecast strong growth in e-business in 2004. We believe that through the streamlining and alignment initiatives completed at Qunara in 2003, this business will be well positioned as demand picks up in future years.

Directory: The Yellow Pages™ brand continues to be the leading brand for directory advertising services in Manitoba. Although competitors have entered the market, their success continues to be limited. As such, we expect to be a steady performer showing modest, but profitable, growth again in 2004.

Liquidity and Capital Resources: Capital spending will continue to focus on efficiently sustaining existing high-margin low-growth business and on migrating investment to the evolving high-growth businesses. Our efforts here will continue to be handled pragmatically in the context of customer requirements. For 2004, we expect that capital expenditures should be approximately $210 million; of this amount, $35 million is allocated to MTS TV. Our operations are expected to continue to provide strong and stable cash flows. We expect that our internally-generated cash, together with cash reserves and access to our existing commercial paper and medium term note programs, will be sufficient to fund operating and capital expenditures and the payment of dividends in 2004. Free cash flow is forecast to be in the range of $45 to $50 million in 2004.

We continued the rollout of our broadband infrastructure to 35 additional communities, extending our high-speed Internet service availability to 79% of Manitobans, which includes 96% of Winnipeg and Brandon.

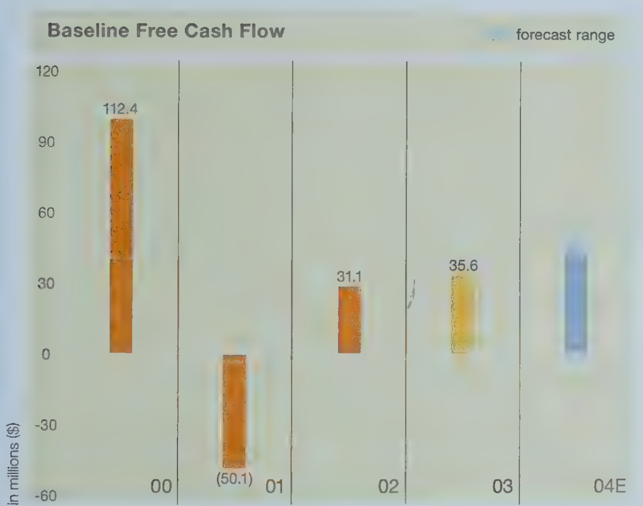
Broadband

We commercially launched our MTS TV service in January 2003 and by year-end, had an installed customer base of 8,693 – well in excess of our original goal of 6,000.

MTS TV

We launched the new specialty magazine *myWinnipeg Business* and expanded our successful *myWinnipeg Life* magazine to four issues per year.

Publications



Providing our shareholders with a solid return on their investment remains at the top of our priorities, along with investing to strengthen the business so that MTS remains a sustainably profitable company. With the proceeds of the put gained by the sale of our investment in Bell West, we have the flexibility to ensure our shareholders benefit directly from this transaction.

Key to a successful 2004 will be our ability to continue implementing our strategy of defending, transforming and expanding the core business in our home market of Manitoba. Broadly speaking, this means:

> Providing our customers with the best services that our industry and our company can offer.

> Continuing to operate efficiently and effectively across all our lines of business.

> Functioning as a strategic infrastructure asset for the Manitoba economy, and being recognized as such by business and government leaders.

> Prudently investing in our business by keeping pace with technology developments, particularly in advances being made in broadband and wireless networking. Our network is a key enabler to our future.

> Being an employer of choice. It is critical to attract, retain, motivate and properly compensate our people to remain a strong company.

> Participating in community life by supporting organizations and causes important to our key stakeholders, including employees, shareholders and our customers. This also supports strategies to advance the reputation of our brand in the market.

MTS enters 2004 once again confident that its strategies, priorities, operations and capabilities are focused on creating shareholder value.

Proposed Transaction

On March 18, 2004, MTS entered into an Arrangement Agreement with Allstream Inc. ("Allstream"), pursuant to which MTS will acquire all of the Class A and Class B shares of Allstream (the "Transaction"). This Transaction combines the strengths of North America's most profitable communications provider with Canada's largest and most profitable alternative communications solutions provider. Our proposal to acquire Allstream creates the opportunity for immediate value enhancement for shareholders, as well as continuing upside potential going forward.

Under the terms of the Arrangement Agreement, Allstream shareholders who are qualifying Canadian residents will receive 1.0909 MTS Common Shares and $23.00 in cash for each Allstream Class A Share and Class B Share. Allstream shareholders who are not qualifying Canadian residents will receive 1.0909 non-voting Class B Preference Shares of MTS and $23.00 for each Allstream Class A or Class B Share. These non-voting Class B Preference Shares will participate equally with Common Shares in all dividends, and are convertible into Common Shares on a one for one basis, subject to foreign ownership restrictions.

This acquisition extends MTS's capabilities and expertise to the national stage, providing significant opportunity for profitable growth and long-term value creation for our shareholders. Underpinning the expanded company will be a strong balance sheet and very profitable operations. On a pro forma basis, the expanded company will have annual revenues of more than $2 billion, in excess of 7,000 employees, a leading-edge fibre based national network infrastructure and more than $3.4 billion in assets.

MTS shareholders will benefit from a substantial issuer bid of approximately $800 million, which we intend to undertake following the closing of the Transaction. The issuer bid will improve liquidity and reduce ownership dilution. It is also expected that the expanded company will produce strong and growing free cash flows. We intend to more than double MTS's annual dividend to $2.20 per share (payable quarterly).

In addition, the Transaction is expected to be immediately accretive to our earnings per share and cash flow per share. While there is a complementary fit to the companies' operations, the Transaction is expected to generate annualized cash savings of approximately $120 million by 2005 through a combination of approximately $40 million of operating synergies and $80 million of cash tax savings as a result of utilizing Allstream's unused tax losses.

The Transaction will be implemented by means of a court-approved plan of arrangement (the "Plan") pursuant to the provisions of the *Canada Business Corporations Act*. The Plan is subject to the approval of Allstream's shareholders. In addition, approval will be required from the court and applicable regulatory authorities.

The Board of Directors of both companies have unanimously approved the Transaction (in the case of MTS, with directors who are nominees of Bell Canada abstaining). The Board of Directors of Allstream is recommending the Transaction for approval by its shareholders at a meeting to be held in May 2004. A circular will be mailed to Allstream shareholders in early April 2004, with closing expected to occur in June 2004.

2004 Financial Outlook

It is expected that on a pro forma basis, the expanded company will achieve 2004 revenues of approximately $2.0 to $2.1 billion, EBITDA of more than $700 million and free cash flow before dividends and buybacks of $280 to

"With a proven record of solid execution, MTS is poised to deliver excellent shareholder value, today and into the future."

William C. Fraser, FCA
President and Chief Executive Officer

$310 million. 2004 earnings per share is forecast to exceed $3.00, and cash earnings per share (defined as earnings per share plus future taxes) is expected to range between $4.50 and $4.65. These forecasts exclude potential post closing 2004 operating synergies. Capital spending in 2004 is forecast at $330 million.

Risks of Integration

The Transaction has been entered into with the expectation that its successful completion will result in long-term strategic benefits, economies of scale and synergies. This will depend, in part, on whether MTS's and Allstream's operations can be integrated in an efficient and effective manner. It is possible that this may not occur as planned, that restructuring costs arising from the integration may be greater than currently expected, and that financial benefits may be less than currently anticipated. In addition to management's focus on integration, MTS's operating results and financial condition could be adversely affected by a number of factors, which include, but are not limited to, geographical, regulatory, labour, and product differences that exist between the two companies. The arrangements between MTS, Bell Canada and their respective affiliates do not contemplate the acquisition and reorganization that will occur as a result of the Transaction. There have been no discussions between MTS and Bell Canada with respect to the impact of the Transaction on such arrangements.

MTS Position on Income Trust Conversion

Our Board of Directors has concluded that the acquisition of Allstream is in the best interest of MTS and can best maximize long-term value creation for our shareholders. In addition, the Allstream acquisition has a number of attributes of an income trust as a result of the availability of Allstream's unused non-capital tax losses. In evaluating a possible conversion to an income trust, our management and Board of Directors carried out an extensive review and analysis of our ability to operate successfully as an income trust. We conducted an extensive analysis of MTS's current and future cash flows and requirements to sustain the company. The Board believes that long-term shareholder value can best be achieved by continuing to follow MTS's proven strategies for delivering value to shareholders through the acquisition of Allstream, which creates the opportunity for immediate value enhancement as well as significant future growth potential. Although we believe the acquisition of Allstream is superior to conversion of the company to an income trust, the completion of the Transaction will not prevent the future conversion of MTS to an income trust, if that is considered desirable for creating shareholder value.

Financial statements and other related information

Contents:

Report on management's responsibility

Management is responsible for the information contained in the annual filings for Manitoba Telecom Services Inc. The annual filings include the accompanying consolidated financial statements, Management's Discussion & Analysis, and Annual Information Form.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and necessarily include some amounts that are based on management's best estimates and assumptions. The information presented in Management's Discussion & Analysis, and elsewhere in the annual report, as well as in the Annual Information Form, is consistent with the information contained in the consolidated financial statements. For the year ended December 31, 2003, each of the President & Chief Executive Officer and Executive Vice-President Finance & Chief Financial Officer have signed and filed the following certifications with respect to the Company's 2003 annual filings.

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Manitoba Telecom Services Inc. for the period ending December 31, 2003;

2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings; and

3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings.

In fulfilling its responsibilities, management, under the direction of the President & Chief Executive Officer and Executive Vice-President Finance & Chief Financial Officer, has developed and maintains a system of internal controls, including systems and processes, policies and procedures, segregation of duties and responsibilities, and an internal audit program. This system is designed to provide reasonable assurance that assets are adequately accounted for and safeguarded, transactions are properly authorized and recorded, and the financial records are reliable for preparing the financial statements and financial information included in Management's Discussion & Analysis and the Annual Information Form.

The Company also maintains an employee *Guide for Business Conduct*, which requires employees to follow high ethical business standards, and a *Corporate Disclosure Policy*, which requires the public disclosure of all material information in accordance with securities regulations.

The Board of Directors carries out its responsibility for the consolidated financial statements, Management's Discussion & Analysis, and Annual Information Form principally through its Audit Committee. The Audit Committee meets periodically with management and with the internal and external auditors to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the consolidated financial statements and other annual filings. The Audit Committee has recommended the consolidated financial statements, Management's Discussion & Analysis, and Annual Information Form to the Board for approval, and the Board has approved these documents.

The consolidated financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who have full access to the Audit Committee, with and without the presence of management. Their report follows.

William C. Fraser, FCA
President & Chief Executive Officer

Wayne S. Demkey, CA
Executive Vice-President Finance & Chief Financial Officer

Audit Committee report

To the Shareholders
Manitoba Telecom Services Inc.

The Audit Committee, which is comprised of eight independent directors appointed by the Board of Directors, ensures that appropriate due diligence has been directed towards the control, accountability and reporting functions of Manitoba Telecom Services Inc. In fulfilling these responsibilities, the Audit Committee makes assessments and determinations and, where appropriate, makes recommendations to the Board of Directors concerning the following matters:

(a) Annual audited financial statements and financial reporting
(b) Interim financial statements and financial reporting
(c) Distribution of financial information to the public
(d) External audit function
(e) Internal audit function
(f) Internal control environment
(g) Employee pension plan governance and administration
(h) Special studies and reviews

The Audit Committee has responsibility to monitor and strengthen the independence of the external and internal audit functions by establishing a direct reporting relationship between the auditors and the Audit Committee, providing a forum for communicating with the Board of Directors, and establishing a governance process over the engagement of the external auditors. Maintaining the independent and objective viewpoint of the external auditors is critical to the external financial reporting process. Accordingly, the Audit Committee has established an *Auditor Independence Policy* to ensure that the external auditors remain independent in fact and in appearance. The *Auditor Independence Policy* applies to all cases where we intend to engage the external auditors, and requires the pre-approval of all non-audit services to be provided by the external auditors.

The text of the Audit Committee's Charter and a summary of the *Auditor Independence Policy* are disclosed in the Company's Annual Information Form.

During 2003, the Audit Committee met independently with each of management and the external auditors to discuss the audited consolidated financial statements, including the quality of internal controls, accounting principles and significant judgments affecting these audited consolidated financial statements. The Audit Committee has received written disclosure from the external auditor regarding their independence.

The Audit Committee has recommended the audited consolidated financial statements and Management's Discussion & Analysis to the Company's Board of Directors for approval, and the Board has approved these documents.

D.H. Penny

Donald H. Penny, FCA, LL.D.
Chairman of the Audit Committee

Auditors' report

To the Shareholders
Manitoba Telecom Services Inc.

We have examined the consolidated balance sheets of Manitoba Telecom Services Inc. as at December 31, 2003 and 2002 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Winnipeg, Manitoba
February 2, 2004, except as to the second
paragraph of Note 20, which is as of March 18, 2004.

Consolidated statement of income

Years ended December 31 (in millions)	2003	2002 (Note 2)
Operating revenues		
Local services	$ 368.1	$ 373.5
Long distance services	189.0	205.5
Wireless services	159.4	137.4
Internet services	44.8	36.0
Directory services	33.1	32.3
e-business services	21.7	23.6
Miscellaneous	28.6	26.8
Bell Intrigna	–	92.2
	844.7	927.3
Operating expenses		
Baseline operations	396.3	395.9
Restructuring costs (Note 3)	5.1	10.0
Bell Intrigna operations	–	111.3
Amortization	224.7	224.4
	626.1	741.6
Operating income	218.6	185.7
Other income	3.9	3.9
Debt charges	(33.2)	(29.5)
Goodwill revaluation (Note 8)	(2.0)	–
Equity losses	(29.8)	(26.2)
Gain on sale of Bell Intrigna (Note 19)	–	94.2
Income before income taxes and non-controlling interest	157.5	228.1
Income taxes (Note 4)		
Current	75.0	76.0
Future	(3.3)	(4.4)
	71.7	71.6
Income before non-controlling interest	85.8	156.5
Non-controlling interest	–	6.0
Net income for the year	$ 85.8	$ 162.5
Basic earnings per share (Note 12)	$ 1.36	$ 2.53
Diluted earnings per share (Note 12)	$ 1.35	$ 2.51

Consolidated statement of retained earnings

Years ended December 31 (in millions)	2003	2002 (Note 2)
Retained earnings, beginning of year		
As previously stated	$ 297.3	$ 204.9
Adjustment for change in accounting policy (Note 2)	(1.3)	–
Retained earnings restated, beginning of year	296.0	204.9
Net income for the year	85.8	162.5
Dividends	(59.1)	(52.6)
Purchase of outstanding Common Shares (Note 12)	(22.9)	(18.8)
Retained earnings, end of year	$ 299.8	$ 296.0

Consolidated statement of cash flows

Years ended December 31 (in millions)	2003	2002 (Note 2)
Cash flows from operating activities		
Net income	$ 85.8	$ 162.5
Amortization	224.7	224.4
Equity losses	29.8	26.2
Cash from (used in) changes in working capital	21.5	(67.9)
Future income taxes	(3.3)	(4.4)
Deferred wireless costs	(18.5)	(18.8)
Net pension funding	(15.4)	(7.6)
Other, net	(0.4)	(4.4)
Gain on sale of Bell Intrigna (Note 19)	–	(94.2)
Non-controlling interest	–	(6.0)
Cash flows from operating activities	324.2	209.8
Cash flows from investing activities		
Capital expenditures, net	(208.1)	(222.2)
Increase in investments	(80.0)	(81.3)
Acquisition (Note 15)	(1.6)	–
Other	1.7	1.6
Cash flows used in investing activities	(288.0)	(301.9)
Cash flows from financing activities		
Dividends	(59.1)	(52.6)
Issuance (repayment) of notes payable, net	57.0	(4.0)
Purchase of outstanding Common Shares (Note 12)	(30.8)	(24.7)
Issuance of share capital (Note 12)	1.9	–
Issuance of long-term debt	–	145.0
Repayment of long-term debt	–	(13.4)
Issuance of share capital by subsidiary to non-controlling interest	–	9.0
Cash flows (used in) from financing activities	(31.0)	59.3
Change in (bank indebtedness) cash and cash equivalents	5.2	(32.8)
(Bank indebtedness) cash and cash equivalents, beginning of year	(9.6)	23.2
Bank indebtedness, end of year	$ (4.4)	$ (9.6)

Consolidated balance sheet

December 31 (in millions)	2003	2002 (Note 2)
ASSETS		
Current assets		
Accounts receivable	$ 82.7	$ 93.8
Prepaid expenses	16.5	16.5
Future income taxes (Note 4)	10.4	4.2
Investment (Note 6)	404.6	–
	514.2	114.5
Property, plant and equipment (Note 5)	1,065.0	1,060.7
Investments (Note 6)	15.1	372.1
Other assets (Note 7)	56.6	39.0
Future income taxes (Note 4)	3.3	1.6
Goodwill and other intangible assets (Note 8)	30.7	31.4
	$ 1,684.9	$ 1,619.3
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Bank indebtedness	$ 4.4	$ 9.6
Accounts payable and accrued liabilities	188.7	178.4
Advance billings and payments	26.1	26.0
Notes payable (Note 9)	68.0	11.0
Current portion of long-term debt (Note 10)	75.0	–
	362.2	225.0
Long-term debt (Note 10)	386.3	461.3
Deferred employee benefits	26.2	27.4
Future income taxes (Note 4)	21.5	16.9
	796.2	730.6
Shareholders' equity		
Share capital (Note 12)	585.5	591.4
Contributed surplus (Notes 2 and 13)	3.4	1.3
Retained earnings	299.8	296.0
	888.7	888.7
	$ 1,684.9	$ 1,619.3

Approved on behalf of the Board

Thomas E. Stefanson, FCA Chairman

Donald H. Penny, FCA, LL.D. Director

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of Manitoba Telecom Services Inc. (the "Company") and its wholly owned subsidiaries, MTS Communications Inc., MTS Media Inc., Manitoba Telecom Services International Inc., AAA Alarm Systems Ltd., and Qunara Inc. The consolidated financial statements also include the accounts of Bell Intrigna Inc. to April 10, 2002 (Note 19).

Use of accounting estimates

The preparation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Revenue recognition

Revenues from local telecommunications, Internet, digital television and e-business services are recognized in the period the services are provided. Revenues from long distance and wireless airtime are recognized based on usage in the period the services are provided. Revenues from telecommunications and e-business related maintenance services are deferred and recognized over the period of the customer contract. Revenues from telecommunications and e-business related product sales are recognized once the product is installed and available for use. Directory revenues are recognized during the period the directory is in circulation.

Cash and cash equivalents (bank indebtedness)

Cash and cash equivalents (bank indebtedness) include cash on hand, net of bank overdrafts, and money market instruments, which are readily convertible into known amounts of cash.

Property, plant and equipment

Property, plant and equipment is recorded at original cost, including materials, direct labour and certain overhead costs associated with construction activity and an allowance for the cost of funds during construction. Amortization is calculated on a straight-line basis over the estimated useful life of property, plant and equipment by applying rates that are based on a continuing program of engineering studies. The composite amortization rate for the year ended December 31, 2003 was 7.8% (2002 – 7.5%).

Investments

The Company uses the equity method to account for its investment in companies subject to significant influence and the cost method for other investments.

Deferred costs

Deferred costs include wireless activation costs and alarm installation costs that are amortized over the estimated periods of benefit, which is normally two years for wireless activation costs, and ten years for alarm installation costs. Deferred costs also include costs associated with the issuance of long-term debt, which are amortized over the term of the issue.

Goodwill and other intangible assets

Goodwill represents the excess of the aggregate purchase price over the fair value of the identifiable net tangible assets and intangible assets purchased at the dates of acquisition. Effective January 1, 2002, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants' ("CICA") Handbook section 3062, Goodwill and Other Intangible Assets. The Company has assigned each of its unamortized goodwill balances to a reporting unit and tests goodwill for impairment on an annual basis, or more frequently if impairment indicators arise. Accordingly, the Company no longer records goodwill amortization.

Other intangible assets represent customer contracts and other contractual arrangements, which are being amortized on a straight-line basis over the estimated period of benefit of four to ten years.

Translation of foreign currencies

Foreign currencies have been translated into Canadian dollars at rates of exchange on the following bases:

i. Monetary assets and liabilities at effective rates prevailing at the end of the year; and
ii. Revenues and expenses at rates prevailing at the respective transaction dates.

Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on the differences between the tax basis of an asset or liability and its carrying amount, and are measured using substantively enacted tax rates, that, at the balance sheet date, are expected to be in effect when the differences are expected to reverse.

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee future benefits

Pension and other employee future benefit costs are determined using the projected benefit method prorated on years of service and based on best estimate assumptions. The discount rate used to calculate the accrued benefit obligation is determined by reference to market interest rates of high quality corporate bonds at the measurement date. Market-related values of pension fund assets are calculated using a four-year moving average of year-end market values. The excess of the net actuarial gain or loss over 10% of the greater of the benefit obligation and the market-related value of plan assets is amortized over the expected average remaining service life of active employees. Transitional assets and obligations, arising upon implementation of the recommendations in CICA Handbook section 3461, are amortized on a straight-line basis over the expected average remaining service life of active employees.

2. CHANGE IN ACCOUNTING POLICY

Stock-based compensation

Effective January 1, 2003, the Company changed its accounting policy for stock options granted to employees from the intrinsic value method to the fair value method, in accordance with the recommendations in CICA Handbook section 3870, Stock-based Compensation and Other Stock-based Payments. In accordance with the fair value method, the Company recognizes estimated compensation expense related to stock options over the vesting period of the options granted, with the related credit being charged to contributed surplus. The recommendations in CICA Handbook section 3870 first became effective on January 1, 2002 for all options granted on or subsequent to this date. During 2002, the Company used the intrinsic value method of accounting for stock options granted to employees, which does not require the recognition of these estimated costs. The Company has applied this change in accounting policy retroactively and has restated the 2002 comparative financial statements, showing the effect of this change on baseline operations expense, net income, retained earnings and contributed surplus in the amount of $1.3 million.

3. RESTRUCTURING COSTS

In the fourth quarter of 2003, the Company recorded a pre-tax restructuring charge in the amount of $5.1 million (2002 – $10.0 million). The restructuring charges represent severance and other employee related costs, resulting from decisions to streamline operations. The 2003 restructuring program is expected to be substantially completed in 2004. As at December 31, 2003, the outstanding liability related to the 2003 restructuring initiative is $4.6 million.

4. INCOME TAXES

A reconciliation of the statutory income tax rate to the effective income tax rate is as follows:

	2003	2002
Combined basic federal and provincial statutory income tax rate	40.1%	42.6%
Bell West equity losses subject to capital gains rates	3.8	2.4
Large corporations tax	0.3	0.4
Impact of future federal and provincial tax rate reductions	0.3	0.5
Gain on sale of Bell Intrigna subject to capital gains rates	–	(9.2)
Adjustment to future taxes to reflect change to equity accounting method for investment in Bell West	–	(6.2)
Other items	1.0	0.9
	45.5%	31.4%

The balances of future income taxes as at December 31, 2003 and 2002 represent the future benefit of unused tax losses, and temporary differences between the tax and accounting bases of assets and liabilities. The major items giving rise to future income tax assets and liabilities are presented below:

	2003	2002
Non-capital loss carryforwards	$ 5.0	$ 3.0
Property, plant and equipment	2.4	1.1
Other assets	(2.3)	(7.0)
Employee benefits and pensions	(8.2)	(2.2)
Other	(4.7)	(6.0)
	$ (7.8)	$ (11.1)

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

4. INCOME TAXES (Continued)

Future income taxes are comprised of:

	2003	2002
Current future income tax asset	$ 10.4	$ 4.2
Long-term future income tax asset	3.3	1.6
Long-term future income tax liability	(21.5)	(16.9)
	$ (7.8)	$ (11.1)

At December 31, 2003, the Company had non-capital loss carryforwards of $14.8 million, the future tax benefit of which has been recognized in the financial statements. If unused, $1.1 million of these tax loss carryforwards expire in the years 2005 to 2008, and $13.7 million expire in the years 2009 to 2010.

During 2003, the Company paid $74.2 million of income taxes (2002 – $150.4 million, of which $76.1 million was paid in respect of 2001 income taxes).

5. PROPERTY, PLANT AND EQUIPMENT

	2003		2002	
	Cost	Accumulated amortization	Cost	Accumulated amortization
Network equipment and outside plant	$ 2,108.4	$ 1,362.6	$ 2,044.0	$ 1,272.9
General equipment and other	404.1	232.2	369.6	217.5
Buildings	171.3	100.4	159.0	92.3
Plant under construction	60.0	–	54.7	–
Materials and supplies	10.1	–	9.8	–
Land	6.3	–	6.3	–
	$ 2,760.2	$ 1,695.2	$ 2,643.4	$ 1,582.7
Net book value	$ 1,065.0		$ 1,060.7	

6. INVESTMENTS

	2003	2002
Investment in Bell West, at equity	$ 404.6	$ 354.4
Long-term investment, at cost	10.8	12.3
Long-term disability fund, at cost	4.3	4.7
Investment, at equity	–	0.7
	419.7	372.1
Less: Investment carried as current (Note 20)	(404.6)	–
	$ 15.1	$ 372.1

The market value of the long-term disability fund is $5.9 million at December 31, 2003 (2002 – $5.6 million).

7 OTHER ASSETS

	2003	2002
Deferred wireless activation costs	$ 18.6	$ 19.1
Deferred alarm installation costs	7.6	6.5
Other deferred costs	5.1	4.4
Pension asset	25.3	9.0
	$ 56.6	$ 39.0

The carrying value of deferred costs is presented net of accumulated amortization. Total amortization of deferred costs charged to operations amounts to $20.4 million in 2003 (2002 – $20.8 million).

The pension asset represents the recognized portion of the net transitional pension asset and employer pension contributions, net of pension expense.

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

8. GOODWILL AND OTHER INTANGIBLE ASSETS

	2003	2002
Goodwill	$ 28.2	$ 30.2
Other intangible assets	2.5	1.2
	$ 30.7	$ 31.4

As at December 31, 2003, other intangible assets were recorded at a cost of $3.6 million (2002 – $1.9 million) less accumulated amortization of $1.1 million (2002 – $0.7 million). Total amortization of other intangible assets charged to operations amounts to $0.4 million in 2003 (2002 – $0.4 million). During 2003, the Company recorded a $2.0 million goodwill revaluation charge to reduce the carrying value of goodwill for its e-business operating segment, Qunara Inc., to the estimated fair value based on annual valuation testing. This charge results from continued softer market conditions for Qunara's services, and the restructuring efforts to focus Qunara on its primary opportunities.

9. NOTES PAYABLE

Notes payable is comprised of short-term commercial paper, and as at December 31, 2003, has interest rates ranging from 2.68% to 2.75% and maturity dates from January 7, 2004 to January 27, 2004.

At December 31, 2003, the Company has lines of credit available in the amount of $200 million. These credit facilities consist of $150 million supporting the commercial paper program, and a $50 million committed operating line of credit for cash management purposes and the issuance of letters of credit.

10. LONG-TERM DEBT

	2003	2002
Medium Term Note, 4.20%, due September 27, 2004	$ 75.0	$ 75.0
Medium Term Note, 7.75%, due March 1, 2005	9.7	9.7
Medium Term Note, 8.75%, due May 15, 2005	34.9	34.9
Medium Term Note, 7.75%, due September 30, 2005	15.5	15.5
Medium Term Note, 8.00%, due April 17, 2006	48.1	48.1
Medium Term Note, 9.00%, due May 2, 2007	14.6	14.6
Medium Term Note, 6.50%, due July 2, 2007	80.0	80.0
Medium Term Note, 8.50%, due September 29, 2007	11.9	11.9
Medium Term Note, 9.125%, due April 3, 2008	27.7	27.7
Medium Term Note, 5.90%, due June 2, 2008	62.0	62.0
Medium Term Note, 5.85%, due February 23, 2009	70.0	70.0
Medium Term Note, 8.625%, due September 8, 2010	11.9	11.9
	461.3	461.3
Less: Current portion of long-term debt	(75.0)	–
	$ 386.3	$ 461.3

Interest expense on long-term debt, including amortization of debt issue costs, amounts to $31.1 million in 2003 (2002 – $28.2 million). Total interest paid during 2003 amounts to $30.8 million (2002 – $27.4 million).

11. FINANCIAL INSTRUMENTS

Fair value
The Company's financial assets and liabilities are initially recorded at the related transaction amount, which is normally the historical cost. When the carrying value of a financial asset exceeds its fair value on a basis that is other than temporary, the carrying value is reduced to the fair value. With the exception of long-term debt, the carrying value of the Company's financial assets and liabilities, which are subject to normal trade terms, approximates the fair value. The Company's long-term debt, with a cost of $461.3 million (2002 – $461.3 million), has a fair market value of $505.5 million as at December 31, 2003 (2002 – $496.6 million).

Credit risk
The Company is exposed to credit risk from its customers. This risk is minimized by the Company's large and diverse customer base.

Derivatives
During the years ended December 31, 2003 and 2002, the Company has not utilized any derivative financial instruments.

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

12. SHARE CAPITAL

Authorized

Unlimited number of Preference Shares of two classes

Unlimited number of Common Shares of a single class

Preference Shares

The two classes of Preference Shares are issuable in one or more series, for which the Board of Directors of the Company may fix the number of shares and determine the designation, rights, privileges, restrictions and conditions. A class of Preference Shares of a single series has been designated as Class A Preference Shares.

The attributes of the Class A Preference Shares are identical in all respects to those of the Common Shares, except for the following:

> The Class A Preference Shares are not entitled to receive notice of, or attend or vote at, meetings of shareholders on resolutions electing Directors.

> The Class A Preference Shares are convertible, at any time, into Common Shares, on a one-for-one basis.

Dividends on the Class A Preference Shares will be payable on the same dates as dividends are paid on the Common Shares of the Company, using the same record date for determining holders of Class A Preference Shares entitled to dividends as the record date for Common Share dividends, in an amount per Class A Preference Share equal to the corresponding amount of dividends per Common Share.

The Class A Preference Shares participate in the earnings of the Company on an equivalent basis with the Common Shares and, therefore, are included in the weighted average number of shares outstanding for purposes of calculating basic and diluted earnings per share.

Common Shares

The holders of the Common Shares have the right to receive notice of, and attend and vote at, meetings of shareholders, to receive such dividends as may be declared by the Board of Directors of the Company, and to share in the distribution of the assets of the Company upon dissolution, subject to the rights, privileges and conditions attaching to any other class of shares ranking in priority thereto.

Issued			2003			2002
	Number		Value	Number		Value
Class A Preference Shares						
Opening balance	1,379,556	$	33.0	7,779,556	$	185.9
Conversion to Common Shares	–		–	(6,400,000)		(152.9)
	1,379,556	$	33.0	1,379,556	$	33.0
Common Shares						
Opening balance	62,312,429	$	558.4	56,724,044	$	411.4
Purchased for cancellation	(881,336)		(7.9)	(811,615)		(5.9)
Issued pursuant to stock options	88,960		2.0	–		–
Conversion of Preference Shares	–		–	6,400,000		152.9
	61,520,053	$	552.5	62,312,429	$	558.4
Total share capital		$	585.5		$	591.4

During the year, the Company purchased 881,336 Common Shares for cancellation for cash consideration of $30.8 million under the terms of its normal course issuer bids (2002 – 811,615 Common Shares for $24.7 million). The excess of the purchase price over the stated capital in the amount of $22.9 million was charged to retained earnings (2002 – $18.8 million). During 2002, 6,400,000 Class A Preference Shares were converted by the holder into 6,400,000 Common Shares. This transaction was recorded at the carrying value of the Class A Preference Shares.

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

12. SHARE CAPITAL (Continued)

Earnings per share reconciliation

The following table provides a reconciliation of the information used to calculate basic and diluted earnings per share:

	2003	2002
Net income		
Net income – basic and diluted	$ 85.8	$ 162.5
Weighted average shares outstanding (in millions)		
Weighted average number of shares outstanding – basic	63.0	64.2
Dilutive effect of outstanding stock options	0.4	0.4
Weighted average number of shares outstanding – diluted	63.4	64.6
Basic earnings per share	$ 1.36	$ 2.53
Diluted earnings per share	$ 1.35	$ 2.51

13. STOCK-BASED COMPENSATION

Employee share ownership plan

Effective January 1, 1998, the Company implemented an employee share ownership plan under which eligible employees can purchase Common Shares of the Company. Eligible employees may contribute between 1% and 6% of salary, with the Company contributing an amount equal to 25% of employee contributions. The Company records its contributions as a component of operating expenses. During 2003, the Company contributed $1.2 million (2002 – $1.1 million) to this plan. All Common Shares purchased on behalf of employees under this plan during the year were purchased at fair market value.

Stock options

The Company has a stock option plan under which the Board of Directors may grant options to purchase Common Shares to employees and Directors at a price not less than the weighted average of the prices at which the Common Shares traded on The Toronto Stock Exchange for the five days immediately preceding the date of grant of the option. The options are exercisable during a period not to exceed ten years. The right to exercise the options accrues over a period of five years of continuous employment at a rate of 20% per year effective on the anniversary of the date on which the options were granted. The Company has reserved a maximum of 3.5 million Common Shares to meet rights outstanding under the stock option plan. The following tables provide further information on outstanding stock options:

	2003		2002	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of year	1,751,250	$ 26.16	1,715,750	$ 26.47
Granted	394,400	34.81	496,500	33.94
Terminated	(73,570)	26.84	(461,000)	35.68
Exercised	(88,960)	21.33	–	–
Outstanding, end of year	1,983,120	28.07	1,751,250	26.16
Exercisable	951,188	21.85	782,170	18.90

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

13. STOCK-BASED COMPENSATION (Continued)

Year granted	Options outstanding	Options exercisable	Weighted average exercise price per share	Expiry date
2003	380,400	–	$ 34.81	2013
2002	430,200	86,040	34.00	2012
2001	318,420	127,368	37.61	2011
2000	214,000	128,400	25.25	2010
1999	153,600	122,880	19.77	2009
1998	80,000	80,000	18.06	2008
1997	406,500	406,500	14.63	2007

In 2003, the Company credited contributed surplus for the recognition of compensation expense related to stock options in the amount of $2.2 million (2002 – $1.3 million), and charged contributed surplus related to the exercise of stock options in the amount of $0.1 million (2002 – nil). In estimating compensation expense for stock options granted to employees, the Company used the Black-Scholes option pricing model. The weighted average assumptions used and weighted average grant date fair value were as follows:

	2003	2002
Risk free interest rate	4.6%	5.1%
Expected volatility	23.6%	23.1%
Expected dividend yield	2.6%	2.6%
Expected life (years)	6	6
Weighted average grant date fair value	$ 8.10	$ 8.31

14. EMPLOYEE FUTURE BENEFITS

The Company has a contributory defined benefit best average pension plan (the "Pension Plan"), which covers the employees of the Company and its subsidiaries, MTS Communications Inc., MTS Media Inc., and Manitoba Telecom Services International Inc. The Pension Plan provides pensions based on length of service and best average earnings. The Company's policy is to fund the Pension Plan as determined through periodic actuarial valuations. Contributions reflect actuarial assumptions regarding salary projections and future service benefits. The Company also provides supplemental pension arrangements and other non-pension employee future benefits that are unfunded with the exception of the long-term disability plan for which the Company has dedicated assets set aside to fund benefits. These assets are recorded on the Company's financial statements.

The actuarial assumptions used in determining the Company's accrued benefit obligations for December 31, 2003 include a discount rate of 6.50% (2002 – 7.00%) for pension liabilities and 6.25% (2002 – 6.75%) for the non-pension employee future benefits liabilities, expected long-term rate of return on plan assets of 7.50% (2002 – 7.50%), and a rate of compensation increase of 3.50% (2002 – 3.75%).

In 2003, the Company recognized a defined benefit pension plan credit of $5.8 million (2002 – $7.6 million) which is comprised of a current service cost (net of employee contributions) of $13.7 million (2002 – $11.6 million), interest on the accrued benefit obligation of $63.0 million (2002 – $63.0 million), an expected return on plan assets of $71.6 million (2002 – $71.3 million), and the amortization of the transitional asset of $10.9 million (2002 – $10.9 million).

The aggregate accrued benefit obligation of the Company's defined benefit pension plans of $981.0 million at December 31, 2003 (2002 – $900.0 million) is comprised of the accrued benefit obligation at January 1, 2003 of $900.0 million (2002 – $841.3 million), current service cost of $23.4 million (2002 – $21.2 million), interest on the accrued benefit obligation of $63.0 million (2002 – $63.0 million), the actuarial loss on the obligation of $41.9 million (2002 – $19.0 million), unamortized prior service costs of $0.3 million (2002 – nil), and benefit payments and transfers of $47.6 million (2002 – $44.5 million). Included in the accrued benefit obligation at year-end is an accrued benefit obligation totaling $5.0 million in respect of plans that are not funded (2002 – $4.1 million).

The fair value of the Pension Plan assets at December 31, 2003 of $934.1 million (2002 – $856.5 million) is comprised of the fair value of plan assets at January 1, 2003 of $856.5 million (2002 – $915.7 million), employee contributions of $9.7 million (2002 – $9.6 million), employer contributions of $9.6 million (2002 – nil), the actual gain on plan assets of $105.9 million (2002 – actual loss $24.3 million), and benefits paid during the year of $47.6 million (2002 – $44.5 million). The excess of the accrued benefit obligation over the fair value of the Pension Plan assets at December 31, 2003 is $46.9 million (2002 – $43.5 million).

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

14. EMPLOYEE FUTURE BENEFITS (Continued)

At December 31, 2003, the accrued pension benefit asset recognized in the financial statements for the Company's contributory defined benefit pension plan is $25.3 million (2002 – $9.0 million), and the accrued pension benefit liability recognized in the financial statements for the Company's supplemental pension arrangements is $3.6 million (2002 – $2.7 million). The unamortized net actuarial loss and unamortized net transitional asset of the Company's defined benefit pension plans are $182.4 million (2002 – $174.7 million) and $114.0 million (2002 – $124.9 million), respectively.

In 2003, the Company recognized an expense relating to the Company's other benefit plans of $1.4 million (2002 – $1.8 million), which is comprised of a current service cost of $1.1 million (2002 – $1.4 million), interest on the accrued benefit obligation of $0.8 million (2002 – $0.9 million), an expected return on plan assets of $0.4 million (2002 – $0.4 million), and the amortization of the transitional asset of $0.1 million (2002 – $0.1 million).

The aggregate accrued benefit obligation of the Company's other defined benefit plans of $12.2 million at December 31, 2003 (2002 – $11.3 million) is comprised of the accrued benefit obligation at January 1, 2003 of $11.3 million (2002 – $13.6 million), current service cost of $1.1 million (2002 – $1.4 million), interest on the accrued benefit obligation of $0.8 million (2002 – $0.9 million), the actuarial loss on the obligation of $0.4 million (2002 – actuarial gain of $3.4 million), and benefit payments of $1.4 million (2002 – $1.2 million).

The fair value of the other defined benefit plans' assets recorded in the financial statements at December 31, 2003 of $5.9 million (2002 – $5.6 million) is comprised of the fair value of plan assets at January 1, 2003 of $5.6 million (2002 – $5.7 million), employer contributions of $1.3 million (2002 – $1.3 million), the actual gain on plan assets of $0.4 million (2002 – actual loss $0.2 million), and benefits paid during the year of $1.4 million (2002 – $1.2 million). The excess of the accrued benefit obligation over plan assets at December 31, 2003 is $6.3 million (2002 – $5.7 million).

At December 31, 2003, the accrued other defined benefit plans' liability recognized in the financial statements is $12.2 million (2002 – $12.6 million), and the book value of the other benefit plans' assets is $4.3 million (2002 – $4.7 million). The unamortized net actuarial gains and unamortized net transitional asset of the Company's other defined benefit plans are $0.8 million (2002 – $1.3 million) and $0.8 million (2002 – $0.9 million), respectively.

15. ACQUISITION

Effective June 20, 2003, the Company acquired all of the operating assets of Alarm All Ltd., a provider of alarm monitoring services, for cash consideration of $1.6 million. This acquisition was accounted for using the purchase method, and the purchase price was allocated to intangible assets of $1.6 million, other assets of $0.2 million, and current liabilities of $0.2 million. Intangible assets represent customer contracts and relationships and are being amortized over the estimated period of benefit of ten years. The operating results of this business are included in the Company's consolidated operating results from the effective date of acquisition.

16. SEGMENTED INFORMATION

As at December 31, 2003, the Company has one reportable operating segment: MTS Communications, which provides a full range of local, long distance, data, wireless, Internet access, digital television, security system and telecommunications-related services. Prior to April 11, 2002, the Company had another reportable operating segment, Bell Intrigna Inc. ("Bell Intrigna"), a competitive local exchange carrier, providing telecommunications products and services to business customers in Alberta and British Columbia. As of April 11, 2002, the Company discontinued the consolidation of the results of Bell Intrigna and began recording the results of Bell West Inc. ("Bell West") on an equity basis (Notes 1 and 19). Bell West is not a reportable segment. Revenues from segments below the quantitative thresholds are attributable to two operating segments of the Company. These segments are MTS Media Inc., which provides directory publishing and media services, and Qunara Inc., which provides e-business services.

The Company evaluates performance based on EBITDA (earnings before interest, taxes, amortization, equity losses, goodwill revaluation and other income). The Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at prices that approximate current market prices.

The following table provides further segmented information:

	MTS Communications		Other segments		Total	
	2003	2002	2003	2002	2003	2002
Operating revenue – external	$ 788.5	$ 778.1	$ 56.2	$ 149.2	$ 844.7	$ 927.3
Operating revenue – internal	3.4	3.4	27.3	27.0	30.7	30.4
EBITDA (Note 2)	428.8	415.5	14.5	(5.4)	443.3	410.1
Amortization	219.5	211.1	5.2	13.3	224.7	224.4
Total assets	1,387.6	1,375.6	521.5	463.4	1,909.1	1,839.0
Capital expenditures, net	201.8	207.3	6.3	14.9	208.1	222.2

Notes to consolidated financial statements

For the years ended December 31, 2003 and 2002
(All financial amounts are in millions, except where noted)

16. SEGMENTED INFORMATION (Continued)

Reconciliations of net income and assets are as follows:

	2003	2002
Net income		
Total EBITDA (Note 2)	$ 443.3	$ 410.1
Amortization	(224.7)	(224.4)
Other income	3.9	3.9
Debt charges	(33.2)	(29.5)
Goodwill revaluation	(2.0)	–
Equity losses	(29.8)	(26.2)
Gain on sale of Bell Intrigna	–	94.2
Income tax expense	(71.7)	(71.6)
Non-controlling interest	–	6.0
Consolidated net income	$ 85.8	$ 162.5
Assets		
Total assets for operating segments	$ 1,909.1	$ 1,839.0
Elimination of inter-segment receivables	(224.2)	(219.7)
Consolidated total assets	$ 1,684.9	$ 1,619.3

17. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Commitments

The Company rents buildings and construction and other equipment under operating leases. Future minimum lease commitments are as follows:

2004	$ 6.3
2005	5.5
2006	4.2
2007	2.2
2008	1.6

On May 30, 2002, the Canadian Radio-television and Telecommunications Commission ("CRTC") issued *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, which governs local rates charged to residential and business customers and the rates that incumbent telephone companies may charge their competitors. In this decision, the CRTC established a regulatory deferral account mechanism, which is expected to be used to fund qualifying initiatives, such as rate reductions, rebates and service improvement plans. The Company estimates its deferral account commitment to be approximately $10 million as at December 31, 2003.

Contractual obligations

The Company has entered into various long-term contractual commitments for services required in the normal course of operations. The aggregate annual contractual commitments for these services in each of the five following fiscal years are as follows:

2004	$ 31.9
2005	18.6
2006	14.2
2007	13.4
2008	8.6

Guarantees

The Company has provided guarantees totaling a maximum of $48 million in favour of the surety under a performance bond and a labour and material payment bond issued to Bell West in respect of its contractual commitment with the Government of Alberta relating to the construction of a high-speed telecommunications network in Alberta. The Company also has guaranteed $3.9 million of a line of credit supporting an irrevocable letter of credit issued by Bell West. Upon completion of the sale transaction of the Company's interest in Bell West (Note 20), the Company's obligations with respect to these guarantees will be terminated.

The Company indemnifies its directors and officers against claims and damages that are incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance in respect of its directors and officers.

Notes to consolidated financial statements

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(All financial amounts are in millions, except where noted)

18. RELATED PARTY TRANSACTIONS

The Company has transactions with related parties in the normal course of operations at prevailing market prices and under normal trade terms. Related parties include Bell Canada, its parent, subsidiaries and significantly influenced affiliates (collectively, "Bell"). The Company is subject to significant influence by Bell due to Bell Canada's ownership of Class A Preference Shares and Common Shares and Bell's representation on the Board of Directors.

During the year, the Company made purchases of goods and services from related parties totaling $17.6 million (2002 – $60.8 million), and sales of goods and services to related parties totaling $11.0 million (2002 – $244.9 million). As at December 31, 2003, the net amount due from related parties totaled $0.3 million (2002 – $0.1 million). The Company also pays amounts to, and receives amounts from, Bell for transiting and terminating long distance minute traffic. These amounts are in the normal course of operations and are at prevailing market prices.

19. GAIN ON SALE OF BELL INTRIGNA

Effective April 11, 2002, the Company entered into an agreement with Bell Canada, BCE Nexxia Inc. ("Bell Nexxia") and Bell Intrigna, whereby Bell Intrigna acquired the operating assets of Bell Nexxia in Alberta and British Columbia as well as certain wireline assets owned by Bell Canada west of Ontario, in exchange for the issuance of shares. After this transaction, this entity continued operations under the name Bell West, owned 60% by Bell Canada and 40% by Manitoba Telecom Services Inc. As a result of this transaction, the Company began accounting for its 40% investment on an equity basis, beginning April 11, 2002, and recognized a pre-tax gain in the amount of $94.2 million on reduction of its ownership interest.

20. SUBSEQUENT EVENTS

Sale of investment in Bell West

The Bell West Unanimous Shareholder Agreement includes certain liquidity provisions in favour of the Company in respect of its investment in Bell West. Effective February 2, 2004, the Company exercised its option to sell its interest in Bell West to Bell Canada at a price equal to a guaranteed floor value of $458 million, plus incremental funding advanced by the Company to Bell West since April 11, 2002, and an 8% return on incremental capital. The Company estimates the proceeds of sale to be approximately $645 million. These proceeds will be received from Bell Canada no later than 180 days after the date of the Company's notice to exercise its option to sell, which is February 2, 2004. The pre-tax gain on sale of the Company's investment in Bell West is estimated to be approximately $230 million.

Proposed acquisition of Allstream Inc.

On March 18, 2004, the Company entered into an agreement with Allstream Inc. ("Allstream"), pursuant to which MTS will acquire all of the Class A and Class B shares of Allstream. Under the terms of the agreement, Allstream shareholders who are qualifying Canadian residents will receive 1.0909 MTS Common Shares and $23.00 in cash for each Allstream Class A Share and Class B Share. Allstream shareholders who are not qualifying Canadian residents will receive 1.0909 non-voting Class B Preference Shares of MTS, which is a new class of shares, and $23.00 for each Allstream Class A Share and Class B Share. The non-voting Class B Preference Shares of MTS will participate equally with Common Shares in all dividends, and are convertible into Common Shares on a one for one basis, subject to foreign ownership restrictions. The Company will account for this acquisition using the purchase method of accounting, and has estimated the purchase price at approximately $1.6 billion. The closing of this proposed transaction, which is subject to approval by Allstream's shareholders, is expected to occur in June 2004.

21. COMPARATIVE FIGURES

The prior period figures have been reclassified where necessary to conform to 2003 presentation.

Five years in review

Not subject to Auditors' Report	2003	2002[1]	2001	2000	1999[1]
FINANCIAL INFORMATION					
(in millions $, except earnings per share & ratios)					
Consolidated operations					
Operating revenues	844.7	927.3	1,003.0	822.2	741.9
Operating expenses	626.1	741.6	861.2	656.9	607.2
Operating income	218.6	185.7	141.8	165.3	134.7
Debt charges	33.2	29.5	25.0	25.6	29.9
Equity losses in Bell West [2]	29.8	26.2	–	–	–
Gain on sale of Bell Intrigna [2]	–	94.2	–	–	–
Net income	85.8	162.5	73.7	100.5	93.9
Earnings per share ($)	1.36	2.53	1.14	1.55	1.34
EBITDA [3]	443.3	410.1	368.0	360.9	324.8
Dividends	59.1	52.6	49.0	49.1	48.0
Capital expenditures, net	208.1	222.2	380.6	270.3	169.4
Baseline (continuing operations) [4]					
Operating revenues	844.7	835.1	820.8	764.1	739.7
Net income	115.2	112.2	112.3	113.0	100.3
Earnings per share ($)	1.83	1.75	1.74	1.74	1.43
EBITDA [3]	448.4	439.2	426.2	385.7	335.1
EBITDA margin (%)	53.1	52.6	51.9	50.5	45.3
Consolidated balance sheet					
Total assets	1,684.9	1,619.3	1,661.9	1,468.1	1,321.4
Property, plant and equipment, net book value	1,065.0	1,060.7	1,289.2	1,110.6	1,022.6
Long-term debt and notes payable [5]	529.3	472.3	344.7	329.7	331.1
Total debt to total invested capital (%)	37.3	34.7	30.1	29.7	31.3
Shareholders' equity	888.7	888.7	802.2	781.8	727.1
BASELINE OPERATIONAL STATISTICS					
Long distance minutes (in thousands)	1,115,692	1,219,005	1,236,813	1,199,015	1,061,457
Cellular subscribers	255,657	234,062	206,447	169,140	143,693
Internet subscribers	129,720	117,554	97,089	73,381	64,901
MTS TV customers	8,693	200	–	–	–
Number of employees	3,418	3,566	3,586	3,125	3,273

(1) Figures for 2002 were restated for a change in accounting policy for stock options granted to employees, which was adopted January 1, 2003. Figures for 1999 were restated to conform to the presentation for bad debt expense and cellular roaming costs first adopted in 2000. Bad debt expense and amounts paid to other carriers for cellular roaming, previously netted against miscellaneous revenues and wireless revenues, respectively, are now included as operations expense.

(2) Effective April 11, 2002, the Company entered into an agreement with Bell Canada, whereby Bell Intrigna Inc. ("Bell Intrigna") acquired the operating assets of BCE Nexxia Inc. in Alberta and British Columbia as well as certain wireline assets owned by Bell Canada west of Ontario, in exchange for the issuance of shares. After this transaction, this combined entity continued operations under the name Bell West Inc. ("Bell West"), owned 60% by Bell Canada and 40% by Manitoba Telecom Services Inc. As a result of this transaction, the Company began accounting for its 40% investment on an equity basis, beginning April 11, 2002 and recognized a pre-tax gain of $94.2 million on reduction of its ownership interest.

(3) Earnings before interest, taxes, amortization, equity losses, goodwill revaluation and other income (expense).

(4) Baseline results exclude the impact of Bell West in 2003 and 2002, and the impact of Bell Intrigna in 2002, 2001, 2000 and 1999. Baseline results from continuing operations also exclude the impact of restructuring charges in 2003 and 2002, and the impact of the goodwill revaluation in 2003.

(5) Includes current portion of long-term debt.

Investor information

MANITOBA TELECOM SERVICES INC.

Subsidiaries
MTS Communications Inc.
MTS Media Inc.
Qunara Inc.
AAA Alarm Systems Ltd.

Corporate headquarters
P.O. Box 6666
333 Main Street
Winnipeg, Manitoba R3C 3V6
http://www.mts.ca

Contact information

For additional investor information, please contact:

Investor Relations
P.O. Box 6666
333 Main Street, Room MP20B
Winnipeg, Manitoba R3C 3V6
Telephone: 1-888-544-5554 or (204) 958-3549
e-mail: investor.relations@mts.ca
Or visit the Investor Relations section on our Web site at http://www.mts.ca

For media and general inquiries, please contact:

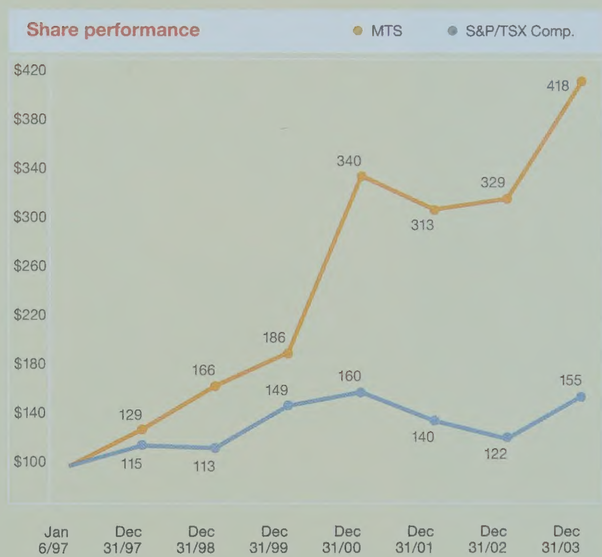
Corporate Communications
P.O. Box 6666
333 Main Street, Room MP18C
Winnipeg, Manitoba R3C 3V6
Telephone: 1-800-565-1936 or (204) 941-8244
e-mail: corporate.communications@mts.ca

For share transfer agent and registrar information, please contact:

Computershare Trust Company of Canada
600, 530 – 8 Avenue SW
Calgary, Alberta T2P 3S8
1-866-331-6360

Market trading information
MTS's Common Shares are listed on The Toronto Stock Exchange. Our trading symbol is MBT.

Duplicate annual reports
If you have received duplicate copies of this annual report, please call MTS Corporate Communications at 1-800-565-1936 or (204) 941-8246.

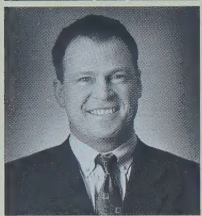


This graph compares the cumulative total return on MTS's Common Shares over the last seven years with the cumulative total return of the S&P/TSX Composite Index, assuming a $100 investment at the initial offering price of $13.00 and reinvestment of dividends.

MTS Management Committee

William C. Fraser, FCA
President & Chief Executive Officer
Manitoba Telecom Services Inc.
Chief Executive Officer
MTS Communications Inc.
Chairman and Chief Executive Officer
MTS Media Inc., Qunara Inc.
and AAA Alarm Systems Ltd.
Winnipeg, Manitoba

Cheryl Barker, CA
President & Chief Operating Officer
MTS Communications Inc.
Winnipeg, Manitoba



Wayne S. Demkey, CA
Executive Vice-President Finance
& Chief Financial Officer
and Corporate Controller
Manitoba Telecom Services Inc.
Winnipeg, Manitoba

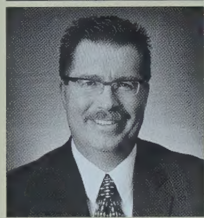
Peter J. Falk, Q.C.
Executive Vice-President
Business Development
General Counsel & Corporate Secretary
Manitoba Telecom Services Inc.
Winnipeg, Manitoba

Roger H. Ballance, P.Eng.
Executive Vice-President
Sales & Marketing
MTS Communications Inc.
Chief Marketing Officer
Manitoba Telecom Services Inc.
Winnipeg, Manitoba

David C. Rourke, P.Eng.
President & Chief Operating Officer
MTS Media Inc.
Winnipeg, Manitoba

Bryan J. Luce
Vice-President Human Resources
Manitoba Telecom Services Inc.
Winnipeg, Manitoba

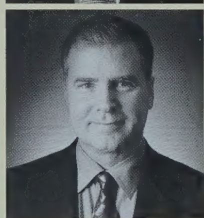
Bonnie Staples-Lyon
Vice-President Corporate Communications
Manitoba Telecom Services Inc.
Winnipeg, Manitoba



Kelvin A. Shepherd, P.Eng.
Vice-President Network Services
& Chief Technology Officer
MTS Communications Inc.
Winnipeg, Manitoba

Patricia A. Solman, CA
Vice-President Customer Care
MTS Communications Inc.
Winnipeg, Manitoba

Stanley M. Kurtas
Vice-President Marketing
MTS Communications Inc.
Winnipeg, Manitoba



Nicholas M. Curry
Acting President & Chief Operating Officer
Qunara Inc.
Vice-President Business Transformation &
Information Technology
MTS Communications Inc.
Winnipeg, Manitoba

Officers of Manitoba Telecom Services Inc.

Thomas E. Stefanson, FCA
Chairman
Manitoba Telecom Services Inc.
and MTS Communications Inc.

William C. Fraser, FCA
President & CEO
Manitoba Telecom Services Inc.
CEO, MTS Communications Inc.
Chairman and CEO
MTS Media Inc., Qunara Inc.
and AAA Alarm Systems Ltd.

Cheryl Barker, CA
President & COO
MTS Communications Inc.

Wayne S. Demkey, CA
Executive Vice-President
Finance & CFO and
Corporate Controller
Manitoba Telecom Services Inc.

Peter J. Falk, Q.C.
Executive Vice-President
Business Development
General Counsel &
Corporate Secretary
Manitoba Telecom Services Inc.

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MTS Communications Inc.
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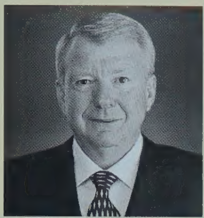
MTS Media Inc.

Nicholas M. Curry
Acting President & COO
Qunara Inc.

Bryan J. Luce
Vice-President
Human Resources
Manitoba Telecom Services Inc.

Brenda M. McInnes, CA
Treasurer
Manitoba Telecom Services Inc.

MTS Board of Directors

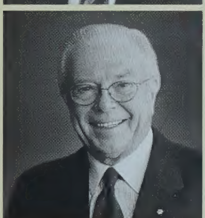


Thomas E. Stefanson, FCA
Chairman, Manitoba Telecom Services Inc. and MTS Communications Inc.
Mr. Stefanson has been Chairman of the Board of Directors since 1989. He is the Chairman of the Governance Committee and a member of the Audit Committee and the Human Resources & Compensation Committee.

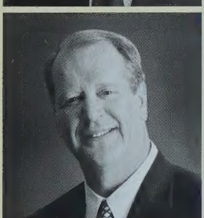
Jocelyne M. Côté-O'Hara
Corporate Director
Ms. Côté-O'Hara has been a member of the MTS Board of Directors since 1997. She is a member of the Audit Committee and the Human Resources & Compensation Committee.

N. Ashleigh Everett
Chairman, Royal Canadian Properties Limited and President, Royal Canadian Securities Limited
Ms. Everett has been a member of the MTS Board of Directors since 1997. She is a member of the Audit Committee and a member of the Human Resources & Compensation Committee.

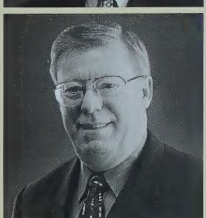
The Honourable Gary A. Filmon, P.C., O.M.
Corporate Director and Business Consultant
Mr. Filmon has been a member of the MTS Board of Directors since 2003. He is a member of the Audit Committee and the Human Resources & Compensation Committee.



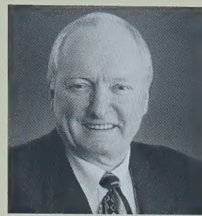
John F. Fraser, O.C., LL.D.
Corporate Director
Mr. Fraser has been a member of the MTS Board of Directors since 1997. He is a member of the Audit Committee and the Governance Committee.



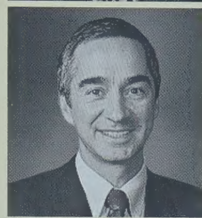
William C. Fraser, FCA
President & CEO
Manitoba Telecom Services Inc.
CEO, MTS Communications Inc.
Chairman and CEO
MTS Media Inc., Qunara Inc. and AAA Alarm Systems Ltd.
Mr. Fraser has been a member of the MTS Board of Directors since 1997.



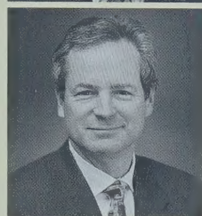
Raymond L. McFeetors
President & CEO
The Great-West Life Assurance Company and London Life Insurance Company
Mr. McFeetors has been a member of the MTS Board of Directors since 1997. He is a member of the Governance Committee.



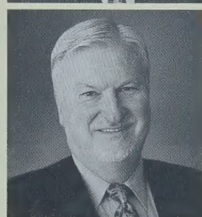
Donald H. Penny, FCA, LL.D.
Chairman, Meyers Norris Penny, LLP
Mr. Penny has been a member of the MTS Board of Directors since 1997. He is the Chairman of the Audit Committee and a member of the Governance Committee.



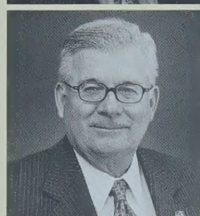
Patrick Pichette
Executive Vice-President, Bell Canada
Mr. Pichette has been a member of the MTS Board of Directors since 2002. He is a member of the Audit Committee.



Randall J. Reynolds
Corporate Director
Mr. Reynolds has been a member of the MTS Board of Directors since 2000. He is a member of the Governance Committee.



Gedas A. Sakus
Corporate Director
Mr. Sakus has been a member of the MTS Board of Directors since 1999. He is a member of the Human Resources & Compensation Committee.



Arthur R. Sawchuk
Chairman, ManuLife Financial Corporation
Mr. Sawchuk has been a member of the MTS Board of Directors since 1997. He is the Chairman of the Human Resources & Compensation Committee and a member of the Governance Committee.

D. Samuel Schellenberg
CEO, Pembina Valley Water Cooperative Inc.
Mr. Schellenberg has been a member of the Board of Directors since 1989. He is Vice-Chairman of the Governance Committee and a member of the Audit Committee.

John W. Sheridan
Corporate Director
Mr. Sheridan has been a member of the MTS Board of Directors since 2000. He is a member of the Human Resources & Compensation Committee.

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